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Supreme Court, U.S.
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No. _____

In the
Supreme Court of the United States
October Term, 1990

STEPHEN ADAMS,

Petitioner,

v.

RESOLUTION TRUST CORPORATION, as receiver for MIDWEST FEDERAL SAVINGS AND LOAN ASSOCIATION,
HAROLD W. GREENWOOD, JR.; DONALD SNEDE; and JOHN DOES 1-10,

Respondents,

and

STEPHEN ADAMS,

Petitioner,

v.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC) as manager of the FSLIC RESOLUTION FUND,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether, without Congressional mandate, it is proper as a matter of "fairness and equity" to favor federally insured depositors and other general creditors over defrauded subordinated debenture purchasers after a federally insured savings and loan association becomes insolvent?

2. Whether the rule of Oppenheimer v. Harriman Nat'l Bank & Trust Co., 301 U.S. 206 (1937) applies to a defrauded purchaser of a subordinated debenture from a federally insured savings and loan association so that, upon insolvency of the institution, the purchaser may rank equally with depositors and other general creditors of the institution?

3. Whether a defrauded purchaser of a subordinated debenture issued by a

federally insured savings and loan association may be estopped from setting off his investment against a loan to him from the institution, dispute the fact that two obligations arose in a single transaction, based on a conclusive presumption that the purchaser must have known his funds would be used for the thrift's regulatory capital?

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IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1990

Stephen Adams,

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v.

Resolution Trust Corporation as
Receiver for Midwest Federal
Savings and Loan Association;
Harold W. Greenwood, Jr.;
Donald Snede; and John Does 1-10,

Respondents,

and

Stephen Adams,

Petitioner,

v.

Federal Deposit Insurance
Corporation (FDIC) as manager
of the FSLIC Resolution Fund,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

Petitioner Stephen Adams [hereinafter "Adams"] respectfully requests that this Court issue a Writ of Certiorari to review the judgment and opinion of the United States Court of Appeals for the Eighth Circuit entered on February 28, 1991, in 927 F.2d. 348 (8th Cir. 1991).

OPINIONS BELOW

The opinion of the Court of Appeals for the Eighth Circuit is reported at 927 F.2d. 348 and is reprinted as Appendix A hereto at 1a. The court's judgment was also entered on February 28, 1991; it is printed in Appendix B hereto at 29a.

The February 9, 1990 decision of the district court, as amended March 2, 1990, is reprinted at 731 F.Supp. 352 (D. Minn. 1990) and ruling of the United States District Court for the District of

Minnesota (Rosenbaum, J.) is printed in Appendix D hereto at 70a-100a. The relevant excerpts of the transcript of proceedings are printed as Appendix G hereto at 108a.

JURISDICTION

The United States Court of Appeals for the Eighth Circuit entered its decision on February 28, 1991. Petitioner has not sought rehearing and this petition is filed within the time prescribed by 28 U.S.C. §2101(c). Petitioner seeks to invoke the jurisdiction of this Court under 28 U.S.C. §1254(1).

STATUTES INVOLVED

The complaint underlying this action was brought against Midwest Federal Savings & Loan Association of Minneapolis under the Federal Savings and Loan Insurance Corporation Act. 12

U.S.C. §1729, et seq. The Financial Institutions Reform, Recovery and Enforcement Act of 1989, 12 U.S.C. §§ 1441 et seq. is also involved in this action. The pertinent sections of each Act are is reprinted in Appendix F hereto at 101a-105a. Petitioner has also reproduced in Appendix F, relevant regulations promulgated under these Acts, 12 C.F.R. §§ 563.8-1, 563.13, 567.2, at 106a-107a.

STATEMENT OF THE CASE

This action was brought by an investor who was fraudulently induced to purchase a subordinated debt security issued by a federally insured and chartered savings institution. Unbeknownst to the investor, the thrift used the investment to increase its regulatory capital. When the investor learned the institution's financial

statements were fraudulent, he brought this action. Before the institution was closed but after the Federal Home Loan Bank Board ("Bank Board") had placed it in conservatorship, the investor then sought to set-off the subordinated debt investment against a loan he had outstanding from the institution. The Bank Board refused the setoff on the ground that the investment and the loan were not "mutual obligations". The investor then brought this action and the institution then went into receivership.

The United States District Court for the District of Minnesota granted a motion for summary judgment dismissing the investor's claims against the receiver. The district court concluded that, although the investor had been defrauded, he was estopped from rescinding the investment because the

institution had used the funds as regulatory capital. As the district court tersely put it: "[the investor] purchased subordinated debt - and that is precisely what he received." 731 F.Supp. at 357; Appendix D at 90a.

A panel of the Eighth Circuit Court of Appeals affirmed. The circuit court found that investments used as regulatory capital are fully encumbered by regulatory obligations and thus, in the event of insolvency, they remain subordinate to claims of depositors and general creditors, despite the institution's fraud upon the investor and the contractual rule that one cannot be bound by a term in a fraudulently induced agreement.

This case is an opportunity for the Court to examine the litigation posture of Resolution Trust Corporation

("RTC"), the institution's receiver, and the damage to principles of justice that courts do when they accept the RTC's insistence that unless the corporation is exempt from the rules that apply to everyone else, the savings and loan crisis may never be resolved. The remedy that was turned on its head in the lower court by this argument is estoppel. By applying the always suspect notion of a conclusive presumption and by legislating a preference for depositors and other creditors over defrauded investors, the panel reached a decision directly at odds with Oppenheimer v. Harriman Nat. Bank, 301 U.S. 206 (1937) and, in effect, authorized the successful completion of a fraud in process.

The Eighth Circuit panel appears to have been under the impression that its ruling would aid the RTC, and

inferentially the taxpayers, by excluding a large group of unsecured creditor claims against insolvent savings and loans. While that may be true in the short-term -- and will surely cause grievously unfair losses to investors far less well situated than petitioner here -- in the long-term it is the death knell for future capital investment in the thrifts that survive the crisis. If the panel decision stands and is followed, it means that no well-advised investor will put new capital into a thrift because, if the financial statements of the association are fraudulent or incorrect, the investor will have no remedy for that wrong when the association becomes insolvent. This short-sighted rule pertains nowhere in commercial law, except as to federally insured thrifts under the panel decision, and is

precisely the unwise policy this Court rejected in Oppenheimer. The Court ought to grant plenary review here and determine whether the Oppenheimer rule, which was born in the Great Depression, should continue into the 90's.

A. Adams Transactions With Midwest Federal

Until 1989, Midwest Federal Savings & Loan Association of Minneapolis ("Midwest Federal") was the second largest federally chartered thrift in the State of Minnesota, having first opened its doors in 1891. Midwest Federal was a mutual savings association, i.e., it had no shareholders. One of the few ways to introduce capital into such an institution, other than through earnings, is by subordinated debentures. A subordinated debenture investor lends funds to the institution, typically for more than five years at an agreed upon

rate of interest and the investment may, but need not, be used as regulatory capital.

A subordinated debt investment is not unlike an equity investment in that the investor subordinates his claim to the claims of all unsecured creditors of the borrower, i.e., all depositors, trade creditors and others. Thus, an investor considering subordinated debt must look to the retained earnings and other equity base to determine whether the investment is prudent. That information is typically supplied to the investor in the form of audited financial statements and unaudited interim financial statements that demonstrate the institution's capital base, the cushion available to protect the investment. Federal law requires that subordinated debt issues of federally chartered thrifts be approved

by the Bank Board. 12 C.F.R. § 563.8-1 (1988); Appendix F at 106a.

In early 1988, Adams was a customer of Midwest Federal, having loans outstanding of over $4 million. Midwest Federal solicited Adams to consolidate several additional loans at Midwest Federal and to borrow as much as $8 million on a new note. At the same time, Midwest Federal asked Adams to invest $2.5 million in subordinated debt to be issued by the thrift. Prior to the investment, Adams received and reviewed audited and unaudited financial statements from Midwest Federal. These financial statements show that Midwest Federal had regulatory capital of over $142 million.

On March 31, 1988, Adams invested $2.5 million and received a subordinated debt instrument issued by Midwest

Federal. The funds for the investment were obtained by Adams through a short-term loan from Midwest Federal itself. (In other words, Adams signed a promissory note for $2.5 million and delivered the note to the savings association in return for a $2.5 million subordinated debt instrument, which we now know was worthless at the time it was issued.)

Several months later, Adams borrowed $7.845 million from Midwest Federal. This loan consolidated Adams' other loans from Midwest Federal and some additional debts, including the $2.5 million loan whose proceeds had been used to purchase the subordinated debt. All of Adams borrowings from Midwest Federal were fully collateralized with, among other things, the controlling interest in a 17-bank holding company of which Adams

was the majority owner.

Unbeknownst to Adams, Midwest Federal used the proceeds of the subordinated debt investment to add to its regulatory capital. 927 F.2d at 348; Appendix A at 1a-28a. There is no contention that Adams knew, or could have known in the reasonable exercise of care, that his investment was necessary for Midwest Federal to meet minimum regulatory capital requirements, i.e., to keep the doors open. In fact, Midwest Federal was then in precarious financial condition.

For a period of time, Adams received the quarterly interest payments due under the subordinated debt agreement. In late 1988, however, Midwest Federal commenced a massive fraud action against one of its former affiliates and the financial strength of

Midwest Federal was publicly called into question. Adams then became suspicious that the financial information he had relied upon in purchasing the subordinated debt was bogus. The institution, however, remained open and publicly insisted it was healthy.

On February 13, 1989, ten months after Adams' subordinated debt investment, the Bank Board determined that Midwest Federal was insolvent and commenced a conservatorship to operate the institution as a going concern. Adams commenced this action on March 21, 1989 against the institution and certain former officers for securities fraud and related wrongs.

On May 4, 1989, the Bank Board determined that Midwest Federal's assets were less than its obligations and the institution was placed in receivership.

As is common in such circumstances, the Bank Board then created a new savings and loan association, Midwest Savings Association ("Midwest Savings") and transferred substantially all of the assets, and all but selected liabilities of the old institution, to the new one. This transaction is known as a "purchase and assumption." Federal Deposit Insurance Corp. v. Citizens Bank & Trust Co., 592 F.2d 364, 366 (7th Cir. 1979) (discussion of purchase and assumption agreements).

Adams was advised that Midwest Federal's liability to owners of subordinated debt securities was excluded from the transfer to Midwest Savings and that no assets of Midwest Federal remain for distribution to holders of subordinated debt. In effect, Adams was told that the Bank Board had left him

holding a claim against an empty shell. The $7.845 million promissory note from Adams to the institution, however, was transferred to Midwest Savings and continues to be an asset of the new institution and a potential claim against Adams.

B. The Complaint

On March 21, 1989, Adams brought this action against Midwest Federal and several of its former officers[1] alleging securities fraud and related wrongs and claiming violation of the Federal Savings

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[1]One of the many ironies of this case is the fact that, while the RTC insists Adams has no effective remedy for having been defrauded, the Department of Justice has indicted several former officers of Midwest Federal for mail fraud for defrauding what are known as the "Series IV" subordinated debenture investors - including Adams. One of the officers has pleaded guilty to securities fraud of the Series IV investors and the others are now being tried in St. Paul, Minnesota. United States v. Olson, et al., U.S. District Court, D. Minn., 3-90-Cr.34.

and Loan Insurance Corporation Act, 12 U.S.C. § 1729, for failure to ratably distribute Midwest Federal's assets, i.e., for excluding his setoff claim from the purchase and assumption. In short, the complaint alleged that the regulatory capital claimed in the financial statements that induced the subordinated debt investment was not present and, in fact, the institution was insolvent at the time Adams made the investment. In lieu of an answer, RTC, which then acted as receiver for Midwest Federal and conservator of Midwest Savings, moved to

dismiss.[2]

C. The District Court Decision

On February 9, 1990, U.S. District Judge James M. Rosenbaum dismissed the action against Midwest Federal and its receiver holding that "[w]hen a subordinated loan is used to enable a financial institution to comply with capital regulations, the subordinated lender properly is estopped from rescinding [his] agreement." 731 F.Supp. 352, 356 (D. Minn. 1990); Appendix D at 88a. Following Northwest Racquet, Swim & Health Clubs, Inc. v. FSLIC, 731

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[2] The Financial Institutions Reform, Recovery, and Enforcement Act ("FIRREA") was enacted on August 9, 1989, to restructure the federal savings and loan regulatory system. 12 U.S.C. §§ 1441-1446. FIRREA created the RTC, 12 U.S.C. § 1441a(b), which assumed most of the receivership, conservatorship, and liquidation functions of the Federal Savings and Loan Insurance Corporation ("FSLIC"), 12 U.S.C. § 1441a(b)(3), (6), and (10). The Act also abolished the FSLIC. 12 U.S.C. § 1725.

F.Supp. 352 (D. Minn. 1989), another case brought by a defrauded Series IV subordinated debt investor against Midwest Federal's receiver, Judge Rosenbaum found it more important that depositors and other creditors of the institution could rely on the stated capital resources of the thrift than that a remedy exist for a defrauded purchaser of the thrift's securities, even if the purchaser was unaware that his investment was used for regulatory capital.

The district court decision analyzed two cases, Oppenheimer v. Harriman National Bank & Trust Co., 301 U.S. 206 (1937) and In Re Weis Securities, 605 F.2d 590 (2d Cir. 1978), cert. denied, 439 U.S. 1128 (1979). In Oppenheimer, this Court held that purchasers of bank stock could rescind their purchases, and rank with unsecured

creditors, if their investments had been fraudulently induced; in Weis, the Second Circuit held that investors in a securities brokerage house, who knew at the time they invested that their funds were being used to meet minimal regulatory capital so a precarious enterprise could continue in business, could not, after discovery of fraud in the inducement, be placed in parity with other unsecured creditors.

Judge Rosenbaum reasoned that Oppenheimer was inapt because the case arose when federal law required shareholders in a federally chartered bank to pay in additional capital in the event of insolvency; the Oppenheimer shareholders were allowed general creditor status because they, in effect, purchased this status by paying in additional capital to pay unsecured

creditors. As to Weis, Judge Rosenbaum stated that the use to which the proceeds of the investment was put is dispositive and not the actual knowledge of that use by the investor; thus if the institution used the funds for regulatory capital, then even if defrauded, the investor could not renounce his subordinated status. 731 F.Supp. at 356, 357; Appendix D at 68a-90a. Judge Rosenbaum bolstered this conclusion by citing Scott v. Deweese, 181 U.S. 202, 212 (1901) and holding that Adams must be conclusively presumed to know that his subordinated debt investment increased Midwest Federal's regulatory capital and

facilitated the conduct of its business.[3]

D. The Court of Appeals Decision

The same panel of the Eighth Circuit Court of Appeals heard Adams' appeal and the appeal in Northwest Racquet the same day and decided them both on February 28, 1991. The Adams decision, 927 F.2d 348 (8th Cir. 1991) relied upon reasoning set forth in Northwest Racquet, Swim & Health Clubs, Inc. v. Resolution Trust Corporation, 927 F.2d 355 (8th Cir. 1991) ("Northwest

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[3]In a second action, Adams v. Federal Deposit Insurance Corporation, petitioner sought to invalidate the purchase and assumption agreement he had with Midwest Savings and thus be entitled to ratable distribution of assets to general creditors. The district court dismissed the second proceeding because, in the first action against, Adams v. Resolution Trust Corp., et al., it determined that because Adams could not rescind his subordinated debenture purchase he retained his subordinated status to general creditors. As a result, the Court concluded that Adams had no right to ratable distribution. Appendix E at 98a-100a.

Racquet"), cert. applied for May 28, 1991.[4] After reviewing Weis, and purporting to distinguish Oppenheimer in a footnote, 927 F.2d at 361 and n. 17, Appendix C at 56a, the Eighth Circuit concluded that the investors were estopped from rescinding their subordination agreements after the date

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[4]The Northwest Racquet opinion is printed in Appendix C hereto at 31a-69a.

of insolvency.[5] 927 F.2d at 360; Appendix C at 52a-53a.

The Eighth Circuit acknowledged that Weis involved investors who knew their investments were being used to keep open the doors of a precarious enterprise, but said it made no difference because Midwest Federal's subordinated debt investors knew their investments could have been used for

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[5]The Court of Appeals makes much of the fact in both cases that on February 13, 1989, the Bank Board declared Midwest Federal insolvent and the subordinated debt investors did not sue until shortly thereafter, Adams, 927 F.2d 348, 353, n. 13, Appendix A at 21a, Northwest Racquet, 927 F.2d at 358, 363, and n. 21, Appendix C at 68a. These details ignore the fact that when Midwest Federal was placed in receivership on February 13, 1989, the Bank Board determined to operate it through a conservatorship as a going concern and it was not until May 4, 1989, that the condition of the institution was deemed too weak to be operated as a going concern and a receiver was appointed. As in Oppenheimer, however, Adams brought this action after the conservatorship commenced but before the receivership began. 301 U.S. 207-208.

regulatory capital and thus "the investors must be conclusively presumed to know that they have increased the institution's capital and facilitated the conduct of its business . . . ." 927 F.2d at 362; Appendix C at 61a. See Scott v. Deweese, 181 U.S. at 212.

The Eighth Circuit essentially saw the dispute here "as one between the investor and general creditors, including innocent depositors." 927 F.2d at 361; Appendix C at 57a. While agreeing that perhaps all such parties "are victims of the institution's fraud," the court concluded that "fairness and equity dictate that investors, having undertaken the greater risk, give way to the depositors and general creditors" when the institution becomes insolvent. Id. Thus, Adams is estopped from claiming he is a general creditor as a victim of a

fraud, and must be subordinated as set forth in the agreement he was defrauded into executing.

REASONS FOR GRANTING THE WRIT

I. THE PANEL DECISION CONFLICTS WITH THIS COURT'S OPPENHEIMER DECISION AND THE SECOND CIRCUIT'S WEIS DECISION.

A. The Panel Decision Renders Oppenheimer a Nullity.

Oppenheimer is a straightforward case. In 1930, Henry Oppenheimer invested $15,120 in Harriman National Bank and Trust Co. The investment was induced "by false and fraudulent representations" by Harriman officers, 301 U.S. 209, and thus the bank "immediately became bound to make restitution," 301 U.S. 213-14; of course at the outset Oppenheimer was unaware he had been cheated and hence that the sale was "subject to rescission by [Oppenheimer] at any time before the declaration of insolvency". Id. at 214.

Shortly after a conservator was appointed for the bank in March 1933, Oppenheimer demanded and later sued for rescission. The bank regulators argued several inconsistent defenses, but did convince the Court of Appeals to limit Oppenheimer to relief only after all unsecured creditors, including depositors, were paid. This Court reversed and held that Oppenheimer was an unsecured creditor of the bank, just like the depositors. Id. at 214.

This Court viewed the case as one of statutory interpretation. After examining several bank regulatory statutes, the Court said the statutes "cannot reasonably be construed to forbid rescission of fraudulent sales by national banks of their own stock". Id. at 211. Unless Congress enacted "language unquestionably disclosing that

purpose," no such intent may be inferred. Id. [Compare Coit Independence v. FSLIC, 489 U.S. 561 (1989)].

Yet in the instant case, the panel below concluded that rescission was barred without citing any statutory language that "unquestionably" or otherwise disclosed such a purpose. The rationale used by the panel was "fairness and equity", not what Congress prescribed.

The Eighth Circuit viewed Oppenheimer as a case to distinguish, not a ruling to follow. The Eighth Circuit turned to a fact distinction between the two cases and concluded it made a crucial legal difference. The fact distinction was that at the time of Oppenheimer investors in national banks were exposed, in the event of insolvency, to an assessment by the comptroller of the

Currency for up to the par value of their stock, i.e., if the bank went under they might have to double their investments. See 12 U.S.C. § 63, repealed in 1959; Appendix F at 101a. The Eighth Circuit said this distinction -- which it apparently thought, erroneously, meant that all unsecured creditors of the bank would be paid in full -- made all the difference in the world. Adams had not been assessed anything -- because there was no comparable law in the 1980's to authorize such assessment -- and the lower court concluded that he could not claim the benefit of Oppenheimer.

This decision demonstrably misreads Oppenheimer and is a paradigm of a distinction without a difference. First, Oppenheimer addressed subordinated debt investments, albeit in dicta. The Court, in trying to point out how the

bank regulatory statutes do not inferentially destroy the rescission remedy, gave some examples of bank liability that squarely apply here:

> "The bank's liability does not differ from what it would be if, instead of shares of its own stock, it had fraudulently sold to plaintiff bonds or other investment securities."

301 U.S. at 211.

Subordinated debt is either a "bond or other investment security."

More fundamentally, however, the Eighth Circuit ignored the essence of Oppenheimer: unless Congress "unquestionably" demonstrates an intention not to allow investors to rescind fraudulently induced investments, they have that right. One searches the Eighth Circuit decisions in Adams and Northwest Racquet for any such congressional statement or intent.

B. **The Real Rationale of the Court of Appeals was to Protect the Government at the Expense of a Private Party - a Rationale That Must be Reviewed by This Court.**

The fact that a Court of Appeals misreads a decision from this Court may not justify a writ of certiorari; the fact that a Court of Appeals draws an apparently unfair distinction between similarly situated parties without congressional mandate is more serious, but also may not justify plenary review. The reason this Court ought to examine this case, however, is because the rationale used by the Court of Appeals is a thinly disguised effort to favor the government over a private party where Congress has not mandated such a result. It is a significant step on the road to a ruinous commercial situation: deal with a federally insured institution at your peril.

The motivation of the Court of Appeals for estopping Adams and the Northwest Racquet claimant was that other creditors of Midwest Federal, especially depositors, have a higher right to recovery than subordinated debt investors after the institution becomes insolvent. This conclusion is supported by the need for depositors and general creditors to look to the regulatory capital of an institution, especially "during an economic downturn, and particularly in the event of insolvency." 927 F.2d at 361. Appendix C at 55a-56a. Thus, on their face, the decisions below claim to protect depositors.

But no depositor will lose a nickel on the failure of Midwest Federal. Federal insurance protects the depositors; they are promptly paid from the insurance fund. 12 U.S.C. § 1728(b).

Indeed, for the same reason, it is most unlikely that any depositor -- unlike a subordinated debt investor -- paid much attention to the financial statements of Midwest Federal or its competitors. The real rationale here was to protect the federal treasury at the expense of Adams and other investors.

Whether the federal treasury should be protected in such circumstances, where Congress has not mandated that result, is a question of serious national importance and should be addressed by this Court.

C. The Panel Decision Distorts In Re Weis and the Concept of Estoppel as to Subordinated Debt Investments.

Vague "regulatory interests" were used by the Eighth Circuit panel to justify the refusal to give Adams a day in court. The Eighth Circuit relied upon In Re Weis Securities, 605 F.2d 590 (2d

Cir. 1978) as authority to estop Adams from rescinding the subordinated debt purchase. Weis involved subordinated loans to a securities broker but, unlike the present circumstances, the Weis investors knew that the broker-dealer was in precarious financial circumstances and their loans were being used to satisfy the regulators so the doors could be kept open, i.e., so others could deal with the broker unaware of his precarious condition.[6]

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[6]See In Re Weis Securities, 425 F.Supp. 212, 216 (S.D.N.Y. 1977)

> ("Weis and subordinated lenders knew that the subordination was to meet the statutory requirements for a broker-dealer to continue in business and knew it was for the protection of the general class of Weis customers who, as long as Weis continued to operate, would continue to incur general obligations of Weis.")

The present case, as the Eighth Circuit admitted, is directly to the contrary: Adams did not know that his $2.5 million contribution was somehow necessary to keep the doors open at Midwest Federal. Another rich irony present in this case is that the way that Midwest Federal defrauded Adams is by claiming that it had $142 million for regulatory capital to serve as a cushion for his investment when, in fact, this capital was illusory and the regulators were breathing down the necks of Midwest Federal's senior managers to add new capital at the end of each quarter. That is why the Adams investment was made at the end of a calendar quarter.

Thus, Weis is a garden variety estoppel case. It would not have been fair for the Weis subordinated debt lenders to stand in the same class as

general creditors when the subordinated debt lenders knew they were investing in a precarious institution and their loans allowed it to remain open, while other creditors did not have that knowledge. The Weis investors were estopped by their own knowledge, a circumstance demonstrably not present here.

This Court should address the question of whether Weis should be read to apply traditional estoppel principles of bar by the victim's own knowledge of certain circumstances, or the novel estoppel view adopted by the Eighth Circuit, of bar by the wrongdoer's

knowledge.[7]

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[7]The Ninth Circuit, in FDIC v. United States National Bank, 685 F.2d 270 (9th Cir. 1982) conflicts with the panel decision here and supports the conclusion that Adams submits. In United States National Bank, the Federal Deposit Insurance Corporation ("FDIC") was on both sides of the case; it proceeded on behalf of a failed bank which had been a subordinated investor in another bank that later failed. The Ninth Circuit allowed rescission and distinguished Weis:

> In Weis, subordinated loans were made to the failed broker-dealer for the specific purpose of insuring the broker-dealer's compliance with the net capital rules. The lenders were aware that the amounts of their loans would not be added to the firm's aggregate indebtedness for purposes of determining compliance.

685 F.2d at 274.

The decision of the Eighth Circuit in the instant case and the decision of the Ninth Circuit in United States National Bank cannot co-exist.

D. **The Decision of the Court of Appeals Allows a Fraud Initiated While an Institution was Operated Under Federal Regulation to be Completed by the Federal Government Itself.**

This case also presents a unique procedural position: the completion of the fraud and the taking of funds from the victim will occur, under the decision of the Court of Appeals, after the RTC has assumed control of the wrongdoing institution and after the fraud has been discovered. The circumstances under which it is appropriate for the RTC to participate in the completion of a banking fraud are worthy of consideration by this Court.

Removed of its procedural garb, the transaction between Adams and Midwest Federal is simple: Adams executed a $2.5 million promissory note and delivered it to the association in return for a $2.5 million subordinated debt instrument. No

money changed hands and the association simply made an accounting change in its ledgers moving funds from another source into an asset classification (the loan to Adams) and the proceeds of that loan into its own equity. Since the loan was secured shortly after it was made, moreover, the institution was never at risk.

Now that fraud has been discovered, the RTC nevertheless insists that it must collect upon the $2.5 million obligation from Adams to Midwest Federal that had its genesis in fraud. In essence, the RTC is completing the fraud. This is a fundamentally different situation than if Adams had paid cash in March, 1988, for the subordinated debt instrument and later the institution had been declared insolvent.

A key issue presented here is the circumstances under which the RTC may complete a bargain that arose due to the fraudulent conduct of bank officers. The litigating posture of the RTC, which argues it has a right to complete such fraudulent transactions, is one that should be approved after only the most careful thought. At risk is the full faith and credit of the United States because people will not long bargain with a party who is free to operate under rules different and less fair than the ones they must abide.

II. THE PANEL DECISION DEPRIVES ALL DEFRAUDED SUBORDINATED DEBT INVESTORS IN FEDERALLY INSURED INSTITUTIONS OF ANY REALISTIC REMEDY AND MUST IMPAIR THE ABILITY OF SURVIVING THRIFTS TO RAISE CAPITAL.

The importance of the question of where defrauded subordinated debt investors stand versus other unsecured

creditors of federally insured institutions is magnified since recently Congress sharply increased the capital requirements for thrifts and subordinated debt is the principal way that any thrifts that survive the current crisis will satisfy the increased requirements. Compare old 12 C.F.R. § 563.13(b), Appendix F at 106a, (savings institutions required to maintain regulatory capital of at least 3% of total liabilities) with new 12 C.F.R. § 567.2(a). Appendix F at 107a. (Savings associations must maintain regulatory capital of at least 6% of category one risk-weighted assets plus an additional 2% of category two risk-weighted assets).

It is easy to predict how investors, especially sophisticated investors, will respond to a rule that persons other than depositors or trade

creditors of a thrift or bank must, even if they were defrauded, stand behind all such other creditors in the event of insolvency. Increased cost of funds for thrift capital is an obvious result, if such funds will be available at all.

The regulatory and investment issues presented by this case are not restricted to thrift institutions. Commercial banks also use subordinated debentures as a method to raise capital. As the failure of federally insured commercial banks continue to rise, the problems illustrated and associated with thrift institutions here, will affect the investments of commercial banking institutions as well. Normally this Court could stand aside and allow the law to develop in the circuit courts. In the present circumstances, that course is not realistic. The capital markets are

making decisions everyday as to whether investors should invest in the thrift crisis survivors. This Court should look now to the question of whether defrauded subordinated debt investors can rely upon Oppenheimer when the institution becomes insolvent, or have to suffer their losses without any remedy.

CONCLUSION

For reasons set forth above, the writ should be granted.

Dated:
May 29, 1991

Respectfully
submitted,

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(2)

90-1851

No. _____

Supreme Court, U.S.
FILED
MAY 29 1991
OFFICE OF THE CLERK

In the

Supreme Court of the United States

October Term, 1990

STEPHEN ADAMS,

Petitioner,

v.

RESOLUTION TRUST CORPORATION, as receiver for MIDWEST FEDERAL SAVINGS AND LOAN ASSOCIATION, HAROLD W. GREENWOOD, JR.; DONALD SNEDE; and JOHN DOES 1-10,

Respondents,

and

STEPHEN ADAMS,

Petitioner,

v.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC) as manager of the FSLIC RESOLUTION FUND,

Respondent.

APPENDIX
TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

No. 90-5123

Stephen Adams, *

*

Appellant, *

*

v. *

*

Resolution Trust Corporation as *
Receiver for Midwest Federal *
Savings and Loan Association; *
Harold W. Greenwood, Jr.; *
Donald Snede; and John *
Does 1-10, *

*

Appellees. *

No. 90-5124

Stephen Adams, *

*

Appellant, *

*

v. *

*

Federal Deposit Insurance *
Corporation (FDIC) as manager *
of the FSLIC Resolution Fund, *

*

Appellee. *

Appeals from the United States
District Court for the
District of Minnesota.

Submitted: September 12, 1990

Filed: February 28, 1991

Before McMILLIAN, Circuit Judge, BRIGHT, Senior Circuit Judge, and BOWMAN, Circuit Judge.

BRIGHT, Senior Circuit Judge.

Stephen Adams (Adams) appeals the district court's[1] grant of summary judgment[2] to the Resolution Trust Corporation (RTC) in this action for rescission of a subordinated debt securities agreement which Adams executed in conjunction with his purchase of $2.5

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[1]The Honorable James M. Rosenbaum, United States District Judge for the District of Minnesota.

[2]The district court's decision is reported as Adams v. Resolution Trust Corp., 731 F. Supp. 352 (D. Minn. 1990).

million in subordinated debt securities from now insolvent Midwest Federal Savings and Loan Association (MWF). On appeal, Adams contends that MWF's insolvency does not affect his right to rescind the agreement by which MWF fraudulently induced him to purchase the securities. According to Adams, a post-insolvency rescission would elevate the subordinated debt to general creditor status, entitling him to set off the debt against a promissory note he executed in favor of MWF. Adams also contends that the district court should not have dismissed as moot his common law fraud claim against the RTC, in its capacity as receiver for MWF, merely because MWF possessed insufficient funds to satisfy a successful damages judgment. Finally, he contends that the district court erred in dismissing his related claim against

the Federal Deposit Insurance Corporation (FDIC) for violating ratable distribution principles in disposing of MWF's assets. We affirm.

I. BACKGROUND

This case arises out of the failure of the Minneapolis based Midwest Federal Savings and Loan Association (MWF) which we visited in Northwest Racquet Swim & Health Clubs, Inc. v. Resolution Trust Corp., Nos. 89-5526, 89-5585, slip op. (8th Cir. Feb. __, 1991) -- a companion case which we discuss below. Stephen Adams, a Florida businessman with interests in banking, broadcasting and publishing, purchased $2.5 million in subordinated debenture securities (Securities) from MWF on March 31, 1988. Adams financed the purchase with funds he borrowed on an apparently unsecured promissory note he executed in favor of

MWF at the time he purchased the Securities. On the same day, Adams executed a subordinated debt securities agreement (Securities Agreement) setting out the terms and conditions of the purchase.

The Securities Agreement expressly subordinated Adams's claims in the event of MWF's liquidation, "to all claims . . . against [MWF] having the same priority as savings account holders or any higher priority."[3] Joint Appendix (J.A.) 66. It also specified the remedies to apply in the event of default. The Securities

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[3]The priority scheme governing claims against an insolvent thrift institution placed savings account holders in the sixth priority position after various administrative costs, expenses and debts associated with the operation of the receivership, various wage and benefits claims of the employees of the failed thrift, and certain government tax claims. 12 C.F.R. § 569c.11 (1989).

Agreement defined default as including failure to make timely payment of the principal or interest due, declaration of insolvency, or the appointment of a conservator, receiver or liquidating agent. A default would also arise in the event that "any representations or warranty made in writing by or on behalf of [MWF] herein or in connection with the transactions . . . shall prove to have been false or incorrect in any material respect on the date as of which made." J.A. 69.

In the event of a default, the remedies section provided that Adams could protect and enforce his rights by an action in law, suit in equity, or other appropriate proceeding. However, the Securities Agreement placed three significant limitations upon Adams' rights, powers and remedies. First, he could accelerate

payment in the event of default only to the extent that such payment did not leave MWF with insufficient capital to meet regulatory capital requirements set out in 12 C.F.R. § 563.13 (1988). Second, in the event that the Federal Savings and Loan Insurance Corporation (FSLIC) was appointed receiver of MWF, FSLIC would have no obligation to arrange for the assumption of the Securities. Finally, the Securities Agreement bound Adams to abide by the priority scheme set out in the Federal Home Loan Bank Board[4] (Bank Board) regulations governing the distribution of assets in liquidation

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[4]The Federal Home Loan Bank Board acted as the principal regulator of the federal savings and loan industry until August 9, 1989, when Title IV of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 354, abolished the Bank Board and replaced it with the Office of Thrift Supervision.

proceedings.[5]

The sale of the Securities was contingent upon Bank Board approval pursuant to 12 C.F.R. § 563.8-1 (1988), governing the issuance of subordinated debt securities by federal savings and loan associations. By letter dated March 31, 1988, Donald Snede, MWF's chief financial officer, stated that the Bank Board had approved the issuance of the note. The Bank Board apparently had given prior approval, on December 21, 1987, to the sale and issuance of up to $25 million in MWF subordinated debt securities.

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[5]Under the regulatory priority scheme, see note 4, the claims of subordinated debt holders like Adams held a ninth rank priority, behind the claims of all general creditors, and ahead only of equity interest holders. 12 C.F.R. § 569c.11 (1989).

MWF immediately applied the Securities to its regulatory capital.[6] From March 31, 1988 through November 1988, the Bank Board recognized the Securities as part of MWF's regulatory capital. In January 1989, however, the Bank Board issued a

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[6]Regulatory capital is the sum of, inter alia, reserve accounts, retained earnings, permanent common stock, securities which constitute permanent equity capital, appraised equity capital and any other nonwithdrawable accounts which constitute the institutions reserves available for satisfying the claims of depositors and other account holders. See 12 C.F.R. § 561.13 (1988). Pursuant to statutory authority, 12 U.S.C. § 1464(s) (1988), the Bank Board, and its successor, the Office of Thrift Supervision (OTS), sets the minimum capital requirements for the industry. Since 1973, the Bank Board or OTS has permitted thrift institutions to include long-term subordinated debt securities as part of their regulatory capital because such securities possess many of the characteristics of permanent capital. 54 Fed. Reg. 34,148 (1989) (commentary accompanying Final Rule amendments to regulations governing the issuance and use of subordinated debt (codified at 12 C.F.R. § 563.13 (1989))); 12 C.F.R. § 561.13 (1988).

directive ordering MWF to prospectively remove the Securities from regulatory capital because Adams had purchased them with funds he had borrowed from MWF on an unsecured basis.

On February 13, 1989, the Bank Board declared MWF insolvent after finding that its obligations to its creditors (including savings account holders) exceeded its assets. Accordingly, the Bank Board exercised its statutory authority under 12 U.S.C. § 1464(d)(6)(A)(i) (1988), and named FSLIC as conservator of MWF. FSLIC attempted to operate MWF as a going concern.

On March 21, 1989, Adams filed the initial complaint against MWF and its officers which gave rise to this action. Adams brought claims for violations of federal and state securities laws, alleging that MWF had fraudulently

induced him to purchase the Securities by making material misrepresentations regarding its financial condition at the time of the transaction.[7] Adams asked the court to declare the Securities Agreement subordinating the investment rescinded and to set off the unpaid balance of the Securities obligation against a $7,485,000 promissory note

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[7]Adams alleged that MWF and its officers did not disclose that one of its assets, which was carried on its books at over $100 million, was the subject of a legal dispute which brought its actual value into question. The dispute over the asset, currently the subject of litigation in federal court, brought into question at least $100 million of MWF's $140 million regulatory capital base, according to Adams. He asserted that MWF's nondisclosure and the resulting misrepresentations regarding its financial condition violated § 10b of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), Rule 10b-5 of the Securities Exchange Commission, 17 C.F.R. § 240.10b-5 (1988), § 12(2) of the Securities Act of 1933, 15 U.S.C. § 771, and Minn. Stat. § 80A.01 (1986), and also constituted common law fraud and breach of contract.

which he owed to MWF.[8] He also sought damages for common law fraud.

Soon after, on April 7, 1989, MWF informed Adams that it would default on the 1989 first quarter interest payment due on the Securities. On May 4, 1989, the Bank Board, noting that MWF's liabilities continued to exceed its assets, concluded that MWF could not be operated as a going concern. The Bank Board, acting pursuant to statutory authority, 12 U.S.C. § 1464(d)(6)(A) (1988); 12 C.F.R. § 547 (1988), appointed FSLIC as receiver for the purpose of liquidating MWF. FSLIC, by operation of law, thus took possession of MWF and succeeded to all of MWF's rights, titles, powers and privileges. See 12 U.S.C. §§ 1464(d), 1729 (1988). In addition, the Bank Board determined that the total

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[8]See note 3.

liquidation of MWF would not generate sufficient funds to satisfy the claims of MWF's general creditors. Therefore, it formally declared all subordinated debt and equity interests in MWF to be worthless.[9]

The Bank Board also contemporaneously created a new savings and loan association, Midwest Savings Association (Midwest Savings), to facilitate the liquidation of MWF and the reorganization of its assets. The Bank Board

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[9]The settlement of claims in the event of liquidation proceeded under an absolute priority scheme, meaning that ninth and tenth priority subordinated debt and equity holders could receive treatment of their claims only after all claims of the first eight ranks had been fully settled. See 12 C.F.R. § 569c.11(d) (1989). Thus, the Bank Board's determination that MWF's assets were insufficient to satisfy the claims of seventh priority general creditors meant that no money remained for the claims of ninth priority subordinated debt holders like Adams.

immediately placed Midwest Savings under FSLIC conservatorship. It further directed FSLIC to enter into a purchase and assumption agreement with Midwest Savings, transferring most of MWF's assets to Midwest Savings in consideration for Midwest Savings, assumption of certain MWF liabilities.

Under the purchase and assumption agreement, Midwest Savings did not assume any MWF subordinated debt or equity liabilities or obligations, including the securities at issue here. As a result of this transaction, the obligations arising from the Securities remained with FSLIC, as receiver for MWF, while Midwest Savings assumed possession of the promissory notes against which Northwest sought to exercise its claimed right of setoff.

Adams responded to these regulatory actions by discontinuing payment on the promissory note now held by Midwest Savings. He also filed a second complaint, on June 28, 1989, against FSLIC in its corporate capacity, in which he contended that the purchase and assumption agreement violated ratable distribution principles implicit in the statutory provision governing the liquidation of failed thrifts, 12 U.S.C. § 1729 (1988). Adams contended that FSLIC should not have transferred Adams' $7,485,000 note to Midwest Savings because it knew that Adams sought to set it off against the Securities which FSLIC also knew MWF had fraudulently induced Adams to purchase. Adams contended that his rescission entitled him to share in the pro rata distribution of MWF's assets to the general creditors. Adams

consequently asked the court to declare the purchase and assumption agreement invalid and permit him to set off the Securities obligations against his MWF loan obligations now held by assignee Midwest Savings.

In February 1990, the district court granted FSLIC's motion for summary judgment in the first action. Adams v. Resolution Trust Corp., 731 F. Supp. 352 (D. Minn. 1990).[10] The district court adopted the analysis of the Second Circuit in In re Weis Sec., Inc., 605

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[10]In August 1989, as part of the overhaul of the thrift industry embodied in the Financial Institutions Reform, Recovery and Enforcement Act, Congress abolished Federal Savings and Loan Insurance Corporation (FSLIC) and replaced it with the Resolution Trust Corporation (RTC). Pub. L. No. 101-73, Title IV, 103 Stat. 354 (1989). During the pendency of the proceedings before the district court, the parties accordingly stipulated to the substitution of RTC, for FSLIC, as receiver of MWF.

F.2d 590 (2d Cir. 1978), cert. denied, 439 U.S. 1128 (1979), and held, as a matter of law, that because MWF had applied the funds from the sale of the Securities to regulatory capital, Adams was precluded from rescinding the Securities Agreement after the Bank Board had declared MWF insolvent. The Securities, therefore, remained subordinated, and thus lacked the requisite mutuality of obligation necessary to set them off against the promissory note.

The district court also dismissed as moot Adams' claim for common law fraud. The Bank Board's determination that Adams' subordinated debentures were worthless because MWF's assets were insufficient to satisfy general creditor liabilities meant, according to the district court, that FSLIC, as receiver,

simply had no assets with which to satisfy a judgment if Adams were to succeed on his common law fraud damages claim. Thus, the court dismissed the damages action on prudential grounds.

In a separate proceeding, the district court also dismissed Adams' second action against FSLIC seeking to invalidate the purchase and assumption agreement with Midwest Savings.[11] The district court again held that because Adams could not rescind the Securities Agreement, he remained a subordinated interest who had no right to participate in the pro rata distribution of assets to the general

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[11]During the pendency of this action, Congress abolished FSLIC, in its corporate capacity, and replaced it with the Federal Deposit Insurance Corporation (FDIC). Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, Title IV, 103 Stat. 354. FDIC, accordingly, now stands in FSLIC's place as defendant and appellee in Adams, second filed action regarding the purchase and assumption agreement.

creditors.[12]

Adams filed this consolidated appeal.

II. DISCUSSION

All but one of Adams' contentions on appeal hinge upon the validity of the district court's determination that the application of his investment to MWF's regulatory capital precluded him from rescinding the Securities Agreement after the date of MWF's insolvency. We addressed this very issue in Northwest Racquet Swim & Health Clubs, Inc. v. Resolution Trust Corp., Nos. 89-5526, 89-5585, slip op. (8th Cir. Feb. __, 1991),

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[12]For the same reasons, the district court also denied Adams, motion to preliminarily enjoin FSLIC from further transferring the assets of MWF and from enforcing the promissory note which Adams had ceased paying. Because Adams was not entitled to rescind the Securities Agreement, the Securities obligation remained subordinated to the higher priority promissory note of general creditor rank. Thus, Adams had no legal interest in the note which might justify enjoining its further transfer.

which was argued before this court on the same day we heard the present appeal. In Northwest Racquet, we held that where investors in a federally regulated institution subordinate their claims in such a manner as to make the investments eligible for use as regulatory capital, and where the issuing institution applies such investments to regulatory capital, the investments must be regarded as fully encumbered by the regulatory obligation to remain subordinate to the claims of depositors and general creditors in the event of insolvency.

The Securities and Securities Agreement at issue in this case are nearly identical to those discussed in Northwest Racquet. As in Northwest Racquet, there is no dispute that the investment, in fact, was included in MWF's regulatory capital from March through November 1988.

Further, the underlying allegations of fraud in the inducement presented in each case also are nearly identical. We therefore refer the reader to our discussion in Northwest Racquet, and hold that MWF's insolvency precludes Adams from rescinding the Securities Agreement.[13] Adams' claim therefore remains subordinate to the claims of general creditors. The continuing subordinated status of the Securities means that they lack the requisite

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[13]We also note that Adams, unlike the plaintiff in Northwest Racquet, did not initiate any remedial action against MWF prior to the declaration of MWF's insolvency. Northwest Racquet attempted to exercise its contractual right to accelerate payment prior to the declaration of insolvency. Adams, by comparison, did not take any remedial action until he filed his initial complaint on March 21, 1989, five weeks after the declaration of insolvency. Thus, the facts of this case provide an even stronger basis for holding that the subordinated debt holder is precluded from rescinding than those presented in Northwest Racquet.

mutuality of obligation required to set them off against the promissory note which holds a superior general creditor rank.[14] The continuing subordination also means that Adams is not entitled to share in any pro rata distribution of assets with MWF's general creditors. Because Adams has no right to participate in any pro rata distribution of assets to general creditors, we also hold that the

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[14]Generally, the right to setoff exists only as to mutual debts. See, e.g., Sioux Line R.R. v. Escabana & Lake Superior R.R., 840 F.2d 546, 551 (7th Cir. 1988). To exhibit the requisite mutuality, the debts must be in the same right. See 5A Michie, Banks & Banking ch. 9, § 115c (1983). Subordinated debentures, however, do not exist in the same right as promissory notes, thus they may not be set off against each other. See FDIC v. Texarkana Nat'l Bank, 874 F.2d 264, 268-69 (5th Cir. 1989) (subordinated debentures in insolvent bank do not, as a matter of both law and equity, meet mutuality of obligation test); see also FDIC v. de Jesus Velez, 678 F.2d 371 (1st Cir. 1982) (subordinated debentures in insolvent bank not mutually extinguishable with promissory notes).

district court properly dismissed his claim attacking the validity of the purchase and assumption agreement between FSLIC and Midwest Savings.

One final issue merits individual attention. Adams contends that the district court should not have dismissed as moot his common law fraud claim for damages against FSLIC in its capacity as receiver for MWF. We agree with the district court's decision declaring the claim moot on prudential grounds because the Bank Board's determination that MWF's assets were insufficient to meet the claims of general creditors meant that the court could not grant subordinate debt holder Adams any effectual relief. 731 F. Supp. at 357-58.

Although it is true, as Adams contends, that in some instances a claim for damages is not mooted merely because of

the insolvency of the defendant, see Ratner v. Sioux Natural Gas Corp., 770 F.2d 512 (5th Cir. 1985), "the feasibility or futility of effective relief should a litigant prevail" remains a crucial consideration in this court's determination of whether to adjudicate a claim on its merits. In re AOV Indus., Inc., 792 F.2d 1140, 1147-48 (D.C. Cir. 1986). To satisfy the case or controversy requirement of Article III of the Constitution, Adams' claimed injury must be redressable by a favorable judicial decision. Iron Arrow Honor Society v. Heckler, 464 U.S. 67, 70 (1983) (per curiam).

The Bank Board formally determined that the claims of subordinated debt holders like Adams are worthless. We are bound by the Bank Board's worthlessness

determination in this proceeding.[15] See Gulley v. Sunbelt Sav., F.S.B., 902 F.2d 348, 351 (5th Cir. 1990), cert. denied, ___ U.S. _____, 111 S. Ct. 673 (1991); Village South Joint Venture v. Federal Deposit Ins. Corp., 733 F. Supp. 50 (N.D. Tex. 1990); Federal Sav. & Loan Ins.

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[15]A Bank Board determination of worthlessness is a "final agency action, which is reviewable under the provisions of the Administrative Procedure Act [, 5 U.S.C. §§ 701-706,] in an action against the Bank Board, but not subject to collateral attack through discovery or other means in individual lawsuits against the receiver." Federal Sav. & Loan Ins. Corp. v. Locke, 718 F. Supp. 573, 586 (W.D. Tex. 1989). Adams has not directly challenged the Bank Board's worthlessness determination. Rather, he has attacked the determination only collaterally, in the context of this action, which does not name the Bank Board as a party to the litigation, but is stated simply against the RTC, as receiver for MWF. Such a collateral attack is not sufficient to create a justiciable issue in the context of the present case. In the absence of a prior adjudication that the Bank Board's worthlessness determination was arbitrary and capricious, Adams has failed to sufficiently state a claim upon which relief could be granted.

Corp. v. Locke, 718 F. Supp. 573, 586 (W.D. Tex. 1989). The import of this determination is that FSLIC, as receiver for MWF, will never have any assets with which to satisfy a common law fraud judgment. Under these circumstances, we follow the axiomatic principle that when "it [is] impossible for [a] court, if it should decide the case in favor of the plaintiff, to grant him any effectual relief whatever, the court will not proceed to a formal judgment."[16] Mills v.

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[16]In Ratner v. Sioux Natural Gas Corp., 770 F.2d 512 (5th Cir. 1985), which Adams cites in support of his arguments, the court, in addressing a mootness defense by an insolvent corporation, stated that the "mere possibility that a judgment debtor lacks the means to satisfy its monetary liability" does not necessarily mean that the case is moot. 770 F.2d at 516 (5th Cir. 1985). Here we are dealing not with the "mere possibility," but rather an absolute certainty that defendant RTC, as receiver for MWF, lacks the means to satisfy a judgment on the common law fraud claim. See Federal Sav. & Loan Ins. Corp. v. Locke, 718 F. Supp. 573, 587 n.4 (W.D. Tex. 1989). Adams contends

Green, 159 U.S. 651, 653 (1895).

Adams contends that adjudication of his claim on the merits is warranted, nonetheless, because resolution of the fraud claim on the merits would aid him in pursuing his pending claims against the former officers of MWF individually. Prudential concerns of judicial economy and preservation of scarce judicial resources counsel that Adams pursue any overlapping issues of fraud within the context of those proceedings.

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that pending litigation over disputed MWF assets raises the possibility that some money may be available, at some future date, to satisfy a common law fraud judgment. This argument, however, overlooks the fact that the assets now belong to Midwest Savings as a result of the purchase and assumption agreement, not to the RTC, as receiver for MWF. RTC no longer holds any MWF assets, let alone assets which might be used to satisfy a judgment in favor of Adams.

III. CONCLUSION

For the reasons expressed above, we affirm the judgment of the district court.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT.

APPENDIX B
UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 90-5123MN

Stephen Adams,

Appellant,

vs.

Resolution Trust Corporation as Receiver for Midwest Federal Savings and Loan Association; Harold W. Greenwood, Jr.; Donald Snede; and John Does 1-10,

Appellees.

No. 90-5124MN

Stephen Adams,

Appellant,

vs.

Federal Deposit Insurance Corporation (FDIC) as manager of the FSLIC Resolution Fund,

Appellee.

Appeals from the United States District Court for the District of Minnesota

JUDGMENT

This appeal from the United States District Court was submitted on the record of the district court, briefs of the parties and was argued by counsel.

After consideration, it is ordered and adjudged that the judgment of the district court in this cause is affirmed in accordance with the opinion of this Court.

February 28, 1991

A true copy.

ATTEST: /s/ Robert D. St. Vrain

CLERK, U.S. COURT OF APPEALS,
EIGHTH CIRCUIT
MANDATE ISSUED: 4/2/91

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

Nos. 89-5526 and 89-5585

Northwest Racquet Swim
& Health Clubs, Inc.,
a Minnesota corporation,

Appellant,

v.

Resolution Trust Corporation,
as receiver for Midwest Federal
Savings and Loan Association
and Midwest Savings Association, F.A.,

Appellees.

Submitted: September 12, 1990

Filed: February 28, 1991

Appeals from the United States District Court for the District of Minnesota.

Before McMILLIAN, Circuit Judge, BRIGHT, Senior Circuit Judge, and BOWMAN, Circuit Judge.

BRIGHT, Senior Circuit Judge.

Northwest Racquet Swim & Health Clubs, Inc. (Northwest) appeals the district court's[1] grant of summary judgment[2] in favor of the Resolution Trust Corporation (RTC) in this action for rescission of subordinated debt securities purchased from now insolvent Midwest Federal Savings and Loan Association (MWF). On appeal, Northwest contends that MWF's insolvency does not affect its right to rescind the securities which MWF fraudulently induced it to purchase. Northwest further asserts that its post-insolvency act of rescission of the securities elevated the

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[1]The Honorable Harry H. MacLaughlin, United States District Judge for the District of Minnesota.

[2]The district court's decision is reported as Northwest Racquet Swim & Health Clubs, Inc. v. Federal Sav. & Loan Ins. Corp., 721 F. Supp. 211 (D. Minn. 1989).

subordinated debt to general creditor status, entitling it to set off the debt against its promissory note obligations to MWF. We affirm the judgment of the district court and substantially agree with its well-reasoned opinion.

I. BACKGROUND

On December 29, 1987, Northwest, a developer and operator of health clubs, purchased $15 million in subordinated debt securities (Securities) in a private offering by MWF, a Minneapolis based, federally insured savings and loan association. Northwest financed its investment with funds from two promissory notes totaling $59 million which it had previously executed with MWF also in December 1987.[3] The Securities contained

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[3]Northwest executed the promissory notes for $10 million and $49 million on December 1 and December 10, 1987, respectively.

language expressly subordinating Northwest's claim, in the event of liquidation, "to all claims against [MWF] having the same priority as savings account holders or any higher priority."[4] Joint Appendix (J.A.) 33. The parties also entered into a subordinated debt securities agreement (Agreement) which similarly subordinated Northwest's claim in the event of the liquidation of MWF.[5]

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[4]The priority scheme governing claims against an insolvent thrift institution placed savings account holders in the sixth priority position after various administrative costs, expenses and debts associated with the appointment and operation of the receivership, various wage and benefits claims of the employees of the failed thrift and certain government tax claims. 12 C.F.R. § 569c.11 (1989).

[5]In addition, Northwest executed an Offeree Statement representing that it had "sufficient knowledge and experience in financial and business matters to be capable of evaluating the merits and risks of [the] proposed investment," that it was "able to bear the economic risk of the proposed investment," and that it had "considered that it might have to hold

The Agreement specified Northwest's remedies in the event of default. Events of default included failure to make timely payment of the principal or interest due, declaration of insolvency, or the appointment of a conservator, receiver or liquidating agent. A default would also arise in the event that "any representations or warranty made in writing by or on behalf of [MWF] herein or in connection with the transactions contemplated hereby shall prove to have been false or incorrect in any material respect on the date as of which made." J.A. 36.

In the event of a default, the remedies

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the proposed investment for an indefinite period of time and might have to bear a complete economic loss." J.A. 177. Northwest similarly executed a Subscription Agreement in which it again stated it had "considered and understands the high degree of risk of the securities offered." J.A. 178.

section provided that Northwest could act to protect and enforce its rights by instituting an action in law, suit in equity, or other appropriate proceeding. However, the Agreement placed three significant limitations upon Northwest's rights, powers and remedies. First, Northwest could accelerate payment in the event of default only to the extent that such payment did not leave MWF with insufficient capital to meet regulatory capital requirements set out in 12 C.F.R. § 563.13 (1988). Second, in the event the Federal Savings and Loan Insurance Corporation (FSLIC) was appointed receiver for MWF, FSLIC would have no obligation to arrange for the assumption of the Securities. Finally, the Agreement bound Northwest to abide by the priority scheme set out in Federal Home

Loan Bank Board[6] (Bank Board) regulations governing the distribution of assets in liquidation proceedings.[7]

The sale of the Securities was contingent upon Bank Board approval pursuant to 12 C.F.R. § 563.8-1 (1988), governing the issuance of subordinated debt securities by federal savings and loan associations. The Bank Board, on December 21, 1987, approved the sale and issuance of up to $25 million in MWF

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[6]The Federal Home Loan Bank Board acted as the principal regulator of the federal savings and loan industry until August 9, 1989, when Title IV of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 354, became law, abolishing the Bank Board and replacing it with the Office of Thrift Supervision.

[7]Under the regulatory priority scheme, see note 4, the claims of subordinated debt holders like Northwest held a ninth rank priority, behind the claims of all general creditors, and ahead only of equity interest holders. 12 C.F.R. § 569c.11 (1989).

subordinated debt securities.

On December 31, 1987, MWF applied the Securities to its regulatory capital, where it constituted more than ten percent of MWF's total regulatory capital through November 1988.[8] In January 1989, however, the Bank Board issued a

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[8]Regulatory capital is the sum of, inter alia, reserve accounts, retained earnings, permanent common stock, securities which constitute permanent equity capital, appraised equity capital and any other nonwithdrawable accounts which constitute the institutional reserves available for satisfying the claims of depositors and other account holders. See 12 C.F.R. § 561.13 (1988). Pursuant to statutory authority, 12 U.S.C. § 1464(s), the Bank Board, and its successor, the Office of Thrift Supervision (OTS), sets the minimum capital requirements for the industry. Since 1973, the Bank Board or OTS has permitted thrift institutions to include long-term subordinated debt securities in their regulatory capital because such securities possess many of the characteristics of permanent capital. 54 Fed. Reg. 34,148 (1989) (commentary accompanying Final Rule amendments to regulations governing the issuance and use of subordinated debt (codified at 12 C.F.R. § 563.13 (1989))).

directive ordering MWF to prospectively remove the Securities from regulatory capital because Northwest had purchased them with funds it had borrowed from MWF on an unsecured basis. MWF, accordingly, did not report the Securities as regulatory capital in its 1988 fourth quarter report to the Bank Board.

Publicity concerning MWF's troubled financial condition prompted Northwest, by letter dated January 25, 1989, to notify MWF that it considered the subordinated debt security to be in default. The letter stated that the events of default "include[d] but are not limited to breach of representations and warranties" made in the Agreement regarding the financial condition of MWF. J.A. 197. Northwest accordingly declared that it was exercising its remedies as set forth in the Agreement.

Specifically, Northwest declared an acceleration of payment of the balance of the principal and demanded immediate payment "in the manner and with the effect provided in the Debenture Agreement." J.A. 198. Northwest also declared an immediate setoff of any remaining amount against its promissory note obligations to MWF.

On February 13, 1989, the Bank Board declared MWF insolvent after finding that its obligations to its creditors (including savings account holders) exceeded its assets. Accordingly, the Bank Board, acting pursuant to its statutory authority under 12 U.S.C. § 1464(d)(6)(A)(i) (1988), named FSLIC as conservator of MWF. FSLIC attempted to operate MWF as a going concern. On March 10, 1989, Northwest again informed MWF by letter that it had concluded that the

sale of the Securities had "involved the misrepresentation of material facts and willful failure to disclose material facts . . . pertaining to the financial condition of [MWF]." J.A. 201. This time, however, rather than assert its contractual remedies as it did in the January 25 letter, Northwest tendered the Securities in rescission and declared an immediate setoff of the amount due against the balance of the two promissory notes held by MWF.

Northwest formalized its allegations of fraud by filing the complaint giving rise to this action in April 1989. The complaint, as later amended, alleged that MWF's material misrepresentations and nondisclosures at the time of the transaction violated state and federal

securities laws.[9] Northwest asked the court to declare the Securities and the Agreement rescinded. It further sought a declaration that the rescission elevated the Securities obligation to general creditor status. According to Northwest, the elevation of the Securities to general creditor status meant that the debt possessed a mutuality

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[9]The financial statements appended to and incorporated into the Agreement stated that an MWF asset identified as a "Finance and Excess Service Fee Income Receivable" had a value of approximately $207 million. Northwest alleged that, at the time of the transaction, MWF officials knew and failed to disclose to Northwest that the asset, which is presently the subject of separate litigation, was likely worth far less than $207 million represented in the financial statements upon which Northwest based its decision to invest. Northwest asserted in its complaint that this material misrepresentation violated § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), Rule 10b-5 of the Securities Exchange Commission, 17 C.F.R. § 240.10b-5 (1988), and Minn. Stat. § 80A.01 (1986).

of obligation with the two promissory notes, entitling it to set off the Securities against the notes.

On May 4, 1989, the Bank Board, noting that MWF's liabilities continued to exceed its assets, concluded that MWF could not be operated as a going concern. Acting under statutory authority, 12 U.S.C. § 1464(d)(6)(A) (1988); 12 C.F.R. § 547 (1988), the Bank Board appointed FSLIC as receiver for the purpose of liquidating MWF. Accordingly, FSLIC, by operation of law, took possession of MWF and succeeded to all of MWF's rights, titles, powers, and privileges. See 12 U.S.C. §§ 1464(d), 1729 (1988). In addition, the Bank Board determined that the total liquidation of MWF would not generate sufficient funds to satisfy the claims of MWF's general creditors, thus, it formally declared all subordinated

debt and equity interests in MWF to be worthless.[10]

The Bank Board also contemporaneously created a new savings and loan association, Midwest Savings Association (Midwest Savings), to facilitate the liquidation of MWF and the reorganization of its assets. The Bank Board immediately placed Midwest Savings under FSLIC conservatorship. It further directed FSLIC to enter into a purchase and assumption agreement with Midwest Savings, transferring most of MWF's

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[10]The settlement of claims in the event of liquidation proceeded under any absolute priority scheme, meaning that ninth and tenth priority subordinated debt and equity holders could receive treatment of their claims only after all claims of the first eight ranks had been fully satisfied. 12 C.F.R. § 569c.11(d) (1989). Thus, the Bank Board's determination that MWF's assets were insufficient to satisfy the claims of seventh priority general creditors meant that no money remained for the claims of ninth priority subordinated debt holder like Northwest.

assets to Midwest Savings in consideration for Midwest Savings' assumption of certain MWF liabilities.

Under the purchase and assumption agreement, Midwest Savings did not assume any MWF equity liabilities or obligations, including the subordinated debt securities at issue here. As a result of this transaction, the obligations arising from the Securities remained with FSLIC, as receiver for MWF, while Midwest Savings assumed possession of the promissory notes against which Northwest sought to exercise its claimed right of setoff. Northwest accordingly amended its complaint to include Midwest Savings as a defendant and requested that the court preliminarily enjoin Midwest Savings from further selling or transferring the notes which Northwest sought to set off.

FSLIC filed a Fed. R. Civ. P. 12(b)(6) motion to dismiss for failure to state a claim. The district court, finding that the disposition of the motion turned on matters outside the pleadings, treated it as a motion for summary judgment and ruled in favor of FSLIC. The district court adopted the analysis of the Second Circuit in In re Weis Sec., Inc., 605 F.2d 590 (2d Cir. 1978), cert. denied, 439 U.S. 1128 (1979), and held, as a matter of law, that because MWF had applied the funds from the sale of the Securities to its regulatory capital accounts, Northwest was precluded from rescinding the Securities after the Bank Board had declared MWF insolvent. The Securities, therefore, remained subordinated, and thus lacked the requisite mutuality of obligation necessary to set them off against the two

promissory notes.[11] Northwest filed this appeal in which it renews the arguments it presented before the district court.[12]

II. DISCUSSION

We review a grant of summary judgment under the same standard applied by the district court. McCuen v. Polk County, Iowa, 893 F.2d 172, 173 (8th Cir. 1989).

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[11]The district court also denied Northwest's motion to enjoin Midwest Savings from further selling or transferring the promissory notes because the motion was predicated upon Northwest's claimed right to set off the Securities against the notes.

[12]During the pendency of this action, Congress created the Resolution Trust Corporation (RTC) as part of its 1989 restructuring of the federal savings and loan regulatory system. See Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183. Under the regulatory reorganization, the RTC assumed most of the receivership, conservatorship and liquidation functions of the FSLIC. Consequently, RTC replaced FSLIC as receiver for MWF and conservator of Midwest Savings, and now stands in FSLIC's place as defendant and appellee in this action.

Thus, we review the facts de novo, Didier v. J.C. Penney Co., 868 F.2d 276 (8th Cir. 1989), and affirm the district court only if we agree that "there is no genuine issue of material fact, viewing the facts in the light most favorable to the non-moving party, and that the moving party is entitled to judgment as a matter of law." McCuen, 893 F.2d at 173 (citing Kegel v. Runnels, 793 F.2d 924, 926 (8th Cir. 1986)); see Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 247, 48 (1986).

Viewing the facts in the light most favorable to Northwest, we must assume that MWF did indeed fraudulently induce Northwest to purchase the Securities by making material misrepresentations regarding its financial condition at the time of the transaction. Neither party disputes that MWF immediately applied the

investment to regulatory capital. In addition, neither party disputes that, as of February 13, 1989, MWF was insolvent. On the basis of these facts, the district court held that Northwest, as a matter of law, was precluded, as of the date of MWF's insolvency, from rescinding the sale of the Securities. Northwest did not attempt to rescind until March 10, 1989, nearly one month after the Bank Board's declaration of MWF's insolvency, thus it was barred from rescinding the Securities.

In reaching its decision, the district court concluded that In re Weis Sec., Inc., 605 F.2d 590 (2d Cir. 1978), resolved the outcome of this case. We therefore focus our attention on Weis. In Weis, lenders to a securities broker-dealer subordinated their loans to the claims of all other creditors in exchange

for a higher rate of return. The subordination, which in effect rendered the loans unencumbered for regulatory purposes, enabled Weis to comply with industry regulatory capital requirements necessary to continue operations. Following Weis' insolvency, the lenders, claiming fraud in the inducement, sought to rescind the subordination agreements.

The Second Circuit rejected the Subordinated lenders' claims, holding that because the lenders had subordinated their loans specifically to enable Weis to comply with regulatory capital requirements, they were estopped from rescinding their subordination agreements following Weis' declaration of insolvency, regardless of whether general creditors actually relied upon the subordination in extending credit to the company. The Weis court analogized the

position of the lenders to shareholders in a series of cases arising under the old National Banking Act, in which those purchasing shares of a national bank were conclusively presumed to have known that they had increased the bank's capital and facilitated its conduct of business. 605 F.2d at 595 (construing Scott v. Deweese, 181 U.S. 202 (1901)). Having assumed such a position, the shareholders were not permitted to escape their statutory liability to the banks creditors at the time of insolvency.[13]

In Scott v. Deweese, for example, a shareholder claiming that he was fraudulently induced to invest in a national bank sought to rescind after the bank had declared its insolvency. In

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[13]Prior to 1959, shareholders of national banks were statutorily liable for the banks' obligations to the extent of the par value of their shares. 12 U.S.C. § 63 (1958) (repealed 1959).

rejecting the shareholder's claim, the Court stated:

> The present suit is primarily in the interest of creditors of the bank. It is based upon a statute designed not only for their protection but to give confidence to all dealing with national banks in respect of their contracts, debts and engagements, as well as to stockholders generally. If the subscriber became a shareholder in consequence of frauds practiced upon him by others, whether they be officers of the bank or officers of the Government, he must look to them for such redress as the law authorizes, and is estopped, as against creditors, to deny that he is a shareholder . . . if at the time the rights of creditors accrued he occupied and was accorded to rights appertaining to that position.

181 U.S. at 213. By analogy, the court in Weis held that, having assumed a subordinate position in order to enable to company to meet federally mandated regulatory capital requirements necessary to continue operations, the lenders were similarly estopped from rescinding their subordination after the date of

insolvency.[14]

The district court deemed Weis analogous to the present action because Northwest's investment, like those of the lenders in Weis, was applied to the regulatory capital of the issuing institution. We agree. The district court stated the Weis "is premised on the fact that the capital regulations reflected 'a strong desire to assure investors of the stability and integrity of the securities markets and of the broker-dealers responsible for channeling investments into them.'" Northwest Racquet Swim & Health Clubs, Inc. v.

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[14]The declaration of insolvency is the critical moment in determining the relationship between various competing interests because "[i]t is well settled that the rights and liabilities of a bank and the bank's debtors and creditors are fixed at the declaration of the bank's insolvency." American Nat'l Bank v. FDIC, 710 F.2d 1528, 1540 (11th Cir. 1983) (citations omitted).

Federal Sav. & Loan Ins. Corp., 721 F. Supp. 211, 216 (D.Minn. 1989) (quoting Weis, 605 F.2d at 596). We believe, contrary to Northwest's assertion, that the regulatory capital requirements of the thrift industry serve similar regulatory interests and purposes as those in the securities industry.

In both industries, regulatory capital acts as a cushion helping the institution to absorb losses in lean times, thus ensuring customers, investors in the securities context and depositors[15] in the

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[15]The purposes of regulatory capital requirements are typically framed in terms of the risk of loss borne by FSLIC (and now the Federal Deposit Insurance Corporation (FDIC)) rather than depositors per se. However, Congress created thrift deposit insurance to promote thrift and protect savings by ensuring that the "saver will get his money back." H.R. Rep. No. 1922, 73d Cong., 2d Sess. 3 (1934) (accompanying Title IV of the National Housing Act, codified as amended as 12 U.S.C. §§ 1724-1730i (1988), repealed by Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-

savings and loan context, of the stability and integrity of the institution in which they have placed their money. See 53 Fed. Reg. 51,800 (proposed Dec. 23, 1988) (commentary on "Purpose of Regulatory Capital" accompanying proposed amendments to regulatory capital requirements codified at 12 C.F.R. §§ 561, 563).[16] The protection provided by regulatory capital requirements, thus, is most critical

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73, Title IV, § 407, 103 Stat. 363) (emphasis added). It is therefore appropriate to view the interests of FSLIC as synonymous with the interests of depositors.

[16]Regulatory capital requirements also "reduce the 'moral hazard' engendered when the insurer bears most of the cost of a thrift's failure . . . [by ensuring that] initial losses are borne not by the insurer, but by the institution's equity and subordinated debt holders, who, through their control of the institution's management, control the actions most likely to lead to insurance losses." 53 Fed. Reg. 51,800 (1988) (emphasis added).

during an economic downturn, and particularly in the event of insolvency. This protection would be severely undermined if, at the time when the protection was most sorely needed, claims of general creditors or depositors were made contingent upon the lower priority claims of subordinated debt and equity interests.[17]

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[17]We disagree with Northwest that Oppenheimer v. Harriman Nat'l Bank & Trust Co., 301 U.S. 206 (1937), sanctions just such a contingency of depositor and general creditor claims. in Oppenheimer, the Court did permit a shareholder in a national bank to rescind his investment on the basis of the bank's fraud after the bank had declared its insolvency. However, the Court deemed the right to rescission contingent upon prior satisfaction of Oppenheimer's statutory liability to the bank's creditors. The Court allowed Oppenheimer's rescission only because he had previously satisfied his statutory obligation:

> Plaintiff appeared by the bank's records to be a stockholder and, as against creditors for whose benefit the statutory liability was created, was estopped from denying that status. Recognizing that the bank's fraud and his rescission availed

An action for rescission by a subordinated debt holder after the date of insolvency must be viewed, in effect, as one between the investor and general creditors, including innocent depositors, Scott v. Deweese, 181 U.S. at 212, because the claim of the rescinding investor "Can be satisfied only out of assets which otherwise would be allocated to making innocent parties whole." Slain & Kripke, The Interface Between Securities Regulation and Bankruptcy--Allocating the Risk of Illegal Securities Issuance Between Securityholders and the Issuer's Creditors, 48 N.Y.U. L.Rev. 261, 286 (1973); see also Scott v. Abbott, 160 F. 573, 581 (8th Cir.), cert. denied, 212 U.S. 571 (1908); In re Stirling Homex

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nothing against the comptroller's assessment, plaintiff paid the amounts laid against him.

301 U.S. at 214.

Corp., 579 F.2d 206, 213 (2d Cir. 1978), cert. denied, 439 U.S. 1074 (1979). It is fair to suggest, in a case such as the one now before us, that all of the parties are victims of the institution's fraud. The question thus becomes which party should receive priority in the settlement of their claims: the investor, who is in the best position to judge the condition of the thrift and influence its management, or the innocent depositors and general creditors.

Northwest asks that the subordinated debt holder be given an equal bite at the apple. This argument is a familiar one which brings to mind the observation of this court many years ago that in the event of an insolvency, "the temptation to lay aside the garb of a stockholder, on one pretense or another, and to assume the role of a creditor, is very strong."

Newton Nat'l Bank v. Newbegin, 74 F. 135, 140 (8th Cir. 1896), quoted in In re Stirling Homex Corp., 579 F.2d at 213. Northwest's request overlooks the fact that the depositors and general creditors "did nothing to create the rescinder's problems and in the overwhelming majority of cases . . . reli[ed] on the existence of the equity or junior debt cushion which the rescinder purported to provide." Slain & Kripke, 48 N.Y.U. L. Rev. at 286. In such situations, fairness and equity dictate that investors, having undertaken the greater risk, give way to the depositors and general creditors by honoring the regulatory obligations they have assumed. It is the regulatory interest of protecting the innocent depositors and general creditors which drove the Second Circuit's analysis in Weis which we now

adopt.

Northwest asserts, however, that under Weis, it cannot be said to have undertaken such a regulatory obligation without a showing that it subordinated its claims with the specific intent of enabling MWF to meet its regulatory capital requirements. As noted above, the lenders in Weis did execute the subordination agreements with the specific intention of enabling Weis to meet its regulatory capital requirements. By comparison, Northwest asserts that it did not know the MWF needed, or would use, the proceeds of the sale of the Securities for regulatory capital purposes. Northwest thus asserts that Weis does not apply under the facts of this case.

We agree that the specific intention of the lenders in Weis was a factor in

the Second Circuit's decision. However, we believe that Northwest reads the implications of Weis too narrowly in light of the regulatory interests at stake. While the facts of Weis appear to limit its application to subordinations with the specific intent of enabling a federally regulated institution to meet mandatory capital requirements, we believe its rationale extends to situations in which parties subordinate their claims in such a manner as to make the investments eligible for use as regulatory capital. Once a federally regulated institution applies such investments to its regulatory capital base, the investors must be conclusively presumed to know that they have increased the institution's capital and facilitated the conduct of its business. See Scott v. Deweese, 181 U.S. at 212. Any other

result would undermine the regulatory protections and priorities accorded innocent third parties who rely upon stated capital reserves.

Under the standard we now enunciate, it is clear that under the facts as presently constituted, Northwest, as a matter of law, is not entitled to any relief. First, both the Securities and the Agreement were structured to render the investment available for use as regulatory capital. The Agreement expressly required that the sale be approved by the Bank Board pursuant to 12 C.F.R. § 563.8-1 (1988), which sets forth numerous terms and conditions for the issuance of subordinated debt securities. Subordinated debt securities meeting the terms and conditions of § 563.8-1 were eligible for use as regulatory capital. 12 C.F.R. § 561.13(c)(1) (1988) ("The

term 'regulatory capital' also includes subordinated debt securities issued pursuant to § 563.8-1").

Section 563.8-1 expressly employs the term "regulatory capital" in conjunction with subordinated debt securities. See 12 C.F.R. § 563.8-1(b)(2)(i) (1988).[18] This provision suggests to us that a subordinated investor such as Northwest should recognize the link between subordinated debentures and regulatory capital, and, more to the point, that this sort of investment might be applied to regulatory capital. We also consider telling the language in the Agreement, as required by the regulations, 12 C.F.R. § 563.8-1(d)(1)(iv) (1988), clearly stating

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[18]We also note that the regulatory capital requirements set out at 12 C.F.R. § 563.13 were expressly referred to in both the regulation governing the approval of the sale of the Securities, and the Agreement itself.

that no payment of principal shall be accelerated without approval of the Bank Board if such payment would leave MWF with insufficient regulatory capital. In agreeing to this provision, Northwest, again, expressly limited its rights and remedies to those available to contributors to regulatory capital. Finally, Northwest agreed to subordinate its claims to those claims having the same priority as savings account holders or higher, again a condition of investments to be devoted to regulatory capital. See 12 C.F.R. § 563.8-1(d)(1)(ii) (1988). Having agreed to terms and conditions that made its investment eligible for use as regulatory capital, Northwest should not now be heard to complain that it was in fact

used in this manner.[19]

Having determined that Northwest Clearly subordinated its investment in a manner that made it eligible for use as regulatory capital, we next look to the record to determine whether the funds, in fact, were used for that purpose. On this issue, there is not dispute. MWF included the investment in regulatory capital beginning in the fourth quarter of 1987 and continuing at least through the third quarter of 1988. We should note that the Bank Board's January 1989 directive instructing MWF to remove the

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[19]If Northwest had alleged that, at the time of the transaction, MWF specifically indicated that the money would not be used for regulatory capital purposes, then we might view this case differently. However, that is not the case we have before us. Northwest has merely asserted that MWF did not expressly state that the investment would be used as regulatory capital. This allegation simply does not create a genuine issue of material fact in light of the terms of the Agreement.

Securities from its reported regulatory capital does not affect our analysis. The Bank Board directed MWF to remove the Securities from regulatory capital only prospectively. The purely prospective nature of the action means that, for regulatory purposes, the Securities must be regarded as regulatory capital from December 1987 until November 1988. Thus, in the final analysis, Northwest's investment must be regarded as fully encumbered by the regulatory obligation to remain subordinate to the claims of depositors and general creditors in the event of insolvency.[20]

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[20]Had the Bank Board ordered the removal of the Securities from MWF's regulatory capital account retrospectively as well as prospectively, this case might have more closely resembled FDIC v. United States Nat'l Bank, 685 F.2d 270 (9th Cir. 1982), upon which Northwest relies. In United States Nat'l Bank, the court permitted a subordinated debt holder to rescind its fraudulently induced investment in a bank despite the fact that the debt holder did

In holding that Northwest may not rescind, we emphasize that we do not hold that a subordinated investor who had agreed to terms and conditions that make his investment eligible for inclusion in regulatory capital never had recourse for fraud. We hold only that such investors may not rescind after the issuing

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not rescind until after the bank had been declared insolvent. The FDIC, as receiver for the insolvent bank, argued that Weis should apply and that no rescission should be permitted post-insolvency. However, National Banking Act regulations governing the subordinated loan at issue in United States Nat'l Bank prohibited the use of subordinated debt as regulatory interests at stake in United States Nat'l Bank. Thus, the court ruled that Weis, in which the subordinated loans could be, and were, used as regulatory capital, was distinguishable and did not apply. For the very reason that the court in United States Nat'l Bank concluded that Weis did not apply, we conclude that United States Nat'l Bank must be distinguished on its facts and does not apply in the present case.

institution has been declared insolvent.[21] The continuing subordinated status of the Securities meas that they lack the requisite mutuality of obligation required to set them off with the promissory note which possesses a superior general creditor rank.[22]

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[21]RTC has asserted that Northwest bound itself to an exclusive set of remedies to apply even in the event of fraud in the inducement, thus suggesting that Northwest cold not have rescinded even prior to the date of insolvency. Our holding does not require us to pass judgment on this issue.

[22]Generally, the right to setoff exists only as to mutual debts. See, e.g., Sioux Line R.R. v. Escabana & Lake Superior R.R., 840 F.2d 546, 551 (7th Cir. 1988). To exhibit the requisite mutuality, the debts must be in the same right. See 5A Michie, Banks & Banking ch. 9, § 115c (1983). Subordinated debentures do not exist in the same right as promissory notes, thus they may not be set off against each other. See FDIC v. Texarkana Nat'l Bank, 874 F.2d 264, 268-69 (5th Cir. 1989) (subordinated debentures in insolvent bank do not, as a matter of both law and equity, meet mutuality of obligation test); see also FDIC v. de Jesus Velez, 678 F.2d 371 (1st Cir. 1982) (subordinated debentures in insolvent bank not mutually

III. CONCLUSION

For the reason expressed above, we affirm the judgment of the district court.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT.

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extinguishable with promissory notes).

APPENDIX D

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION
Civil No. 4-89-330

Stephen ADAMS

v.

RESOLUTION TRUST CORPORATION, as Receiver for Midwest Federal Savings and Loan, et al.

February 9, 1990.
As Amended
March 2, 1990.

Timothy D. Kelly, Diane M. Helland, KELLY & BERENS, 80 South Eighth Street, #3720, Minneapolis, Minnesota 55402, for plaintiff.

John Paul Martin, John E. Yanish, Jeffrey G. Stephensen, PETERSON, TEWS & SQUIRES, 80 South Eighth Street, #4800, Minneapolis, Minnesota 55402, for defendant RTC.

ORDER

ROSENBAUM, District Judge

Defendant FSLIC (the Federal Savings and Loan Insurance Corporation), now the

RTC (Resolution Trust Corporation),[1] in its role as receiver for Midwest Federal Savings and Loan Association (Midwest Federal), seeks judgment on the pleadings, pursuant to Rule 12, Federal Rules of Civil Procedure, (Fed.R.Civ.P.).[2] Based upon the files, records, proceedings, and oral arguments herein, and for the reasons set forth

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[1]On August 9, 1989, the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) became law. Pub.L.No. 101-73, 103 Stat. 183. Section 401(f) (2) abolishes the FSLIC and substitutes the Resolution Trust Corporation (RTC) as its successor. Id. at 356. A stipulation and order to substitute RTC, as receiver, for FSLIC, as receiver, was signed by the parties and the magistrate and was filed November 7, 1989. For purposes of this motion the Court will continue to refer to the defendant as the FSLIC.

[2]While the FSLIC has styled its pleading as a motion to dismiss pursuant to Rule 12(b)(6), Fed.R.Civ.P., the Court has considered affidavits and documents outside the pleadings. Thus, this motion is treated as one for summary judgment. Rule 12(b) and (c) and Rule 56, Fed.R.Civ.P.

below, defendant's motion, considered as if for summary judgment, is granted.

Facts

Plaintiff is a Florida businessman who purchased $2.5 million in subordinated debentures issued by Midwest Federal on March 31, 1988. Defendant FSLIC was a congressionally created agency of the United States charged with protecting the financial integrity of the savings and loan industry. The RTC, FSLIC's statutory successor, is currently the receiver for Midwest Federal, a failed financial institution.

On February 13, 1989, some ten months after plaintiff's purchase of the subordinated debentures, the Federal Home Loan Bank Board (FHLBB) determined that Midwest Federal was insolvent and appointed the FSLIC as conservator of Midwest Federal. FHLBB Resolution 89-

179, at 2.

On March 21, 1989, plaintiff brought this action against Midwest Federal and several former officers of Midwest Federal.[3] Plaintiff seeks to rescind the subordination agreement claiming he was fraudulently induced to make the $2.5 million loan. Plaintiff also seeks to set off the entire unpaid balance of the subordinated debentures against a $7,845,000 promissory note, dated June 30, 1988, which plaintiff owes to Midwest Federal.

On May 4, 1989, having determined Midwest Federal's assets to be less than

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[3]The action was originally filed in Hennepin County as a Minnesota state court proceeding against Midwest Federal and others as defendants. It was subsequently removed to this Court on the petition of the FSLIC, as conservator. The parties stipulated on July 6, 1989, to the substitution of the FSLIC, as receiver, as party defendant for Midwest Federal.

its obligations, the FHLBB replaced the FSLIC as conservator with the FSLIC as receiver. FHLBB Resolution 89-1388 at 1-2. On the same date, the FHLBB created a new savings and loan association, Midwest Savings Association. The FHLBB then directed the FSLIC as receiver to transfer substantially all of Midwest Federal's assets, and certain of its liabilities, to Midwest Savings via a purchase and assumption transaction. FHLBB Resolution 89-1389 at 2-5.

The result of these proceedings is that the FSLIC (now RTC), as receiver, holds Midwest Federal's obligation on the subordinated debentures and Midwest Savings, with FSLIC (now RTC) as its conservator, holds plaintiff's obligation on the promissory note.

At the time this case was removed, jurisdiction was conferred upon this

Court by 12 U.S.C. §1730(k)(1).[4]

Plaintiff's Contentions

Plaintiff's 1988 debenture purchase was memorialized in a written agreement. A review of that document shows it to be replete with language making clear the subordinate nature of the debt. The document is entitled "SUBORDINATED DEBT SECURITIES AGREEMENT." Amended Complaint, Ex. C, title page. The introductory paragraph of the agreement states "the Lender agrees to purchase, subordinated debt securities." Id. at 1. Paragraph 1 of the agreement sets forth Midwest Federal's authority to issue subordinated debt securities. Id.

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[4]Section 407 of FIRREA repeals 12 U.S.C. §1730 (k)(1). Pub.L. No. 101-73, §407, 103 Stat. 183, 363 (1989). Section 209 of FIRREA amends 12 U.S.C. §1819, which is now the relevant jurisdictional provision. Id. at 216. This Court presently has jurisdiction, pursuant to 12 U.S.C. §1819, as amended.

Paragraph 3 states the notes are not secured by the assets of Midwest Federal and cannot be held by an FSLIC-insured institution. Id. at 3. Paragraph 11 states:

> Payment of the principal of and interest on the Notes is hereby expressly subordinated on liquidation to all claims (including post default interest) against [Midwest Federal] having the same priority as savings account holder or any higher priority. Further, for any and all purposes whatsoever, the Notes shall be subordinate to the 8-1/4% $8 million subordinated debentures of [Midwest Federal] due in 1993.

Id. at 14. Paragraph 20 also contains an explicit subordination in the event of the failure of Midwest Federal:

> If the FSLIC shall be appointed receiver for [Midwest Federal] and . . . shall arrange for the assumption of less than all of the liabilities of [Midwest Federal] by one or more other insured institutions, the FSLIC shall have no obligation . . . to contract for or otherwise arrange for the assumption of the obligation represented by the Note in whole or in part . . ..

Id. at 20.

It is plaintiff's contention that he did not know his investment in these debentures would be used to enable Midwest Federal to meet its regulatory capital requirements. In the absence of contrary evidence, at this point in the proceedings, the Court assumes this to be true. But whatever the state of plaintiff's knowledge, Midwest Federal did include the $2.5 million in its regulatory capital. Affidavit of Steven L. Opsal, ¶¶7-9; Affidavit of Lynne Blixt, ¶¶4-6. In January, 1989, the FSLIC directed that Midwest Federal cease the inclusion of the subordinated debentures in its regulatory capital base. Opsal Affidavit at ¶10. The directive was issued because it appeared the subordinated debentures had been purchased with funds loaned by Midwest

Federal.[5]

Plaintiff, by this action, first seeks to rescind the subordinated debenture agreement and, then, seeks to set off the amount he claims is due against his promissory note, now held by Midwest Savings. Plaintiff argues he is entitled to rescission because Midwest Federal made material misrepresentations which induced him to enter into the subordinated debt securities agreement. It is his position that upon rescission he would be entitled to rank in parity with general creditors. He then argues that this elevation in status creates a mutuality of obligation which permits the debentures to be set off against his

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[5]This arrangement was acknowledged by counsel for plaintiff at oral argument. Tr. of motion proceedings, at 19-20 (Aug. 24, 1989). Plaintiff borrowed from Midwest Federal to secure the funds he used to purchase these debentures.

promissory note. Plaintiff contends the right to set-off was effective upon Midwest Federal's insolvency, so that Midwest Savings took the promissory note subject to the set-off.

Analysis

Summary judgment is appropriate if there is not genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. Rule 56(c), Fed.R.Civ.P. "Summary judgment procedure is properly regarded not as a disfavored procedural shortcut, but rather as an integral part of the Federal Rules as a whole . . .." Celotex Corp. v. Catrett, 477 U.S. 317, 327 (1986). Prior to the Federal Rules of Civil Procedure and notice pleading, motions to dismiss a complaint or strike a defense were the primary tools to prevent factually insufficient claims

from proceeding to trial. Id. Under notice pleading, summary judgment assumes this integral function. Id.

Summary judgment may be granted against a party who fails to make a showing sufficient to establish the existence of an element essential to its case and on which that party will bear the burden of proof at trial. Id. at 322-23. The party opposing summary judgment must produce concrete facts demonstrating there is a genuine issue of fact for trial. Buford v. Termayne, 747 F.2d 445, 447 (8th Cir.1984).

Plaintiff asserts he is entitled to set off these debentures against his loan from Midwest Federal. The right to set-off exists only as to mutual debts. Soo Line R. Co. v. Escanaba & Lake Superior R. Co., 840 F.2d 546, 551 (7th Cir.1988); Olsen-Frankman Livestock Mktg. Serv.,

Inc. v. Citizens Nat'l Bank, 605 F.2d 1082, 1087 (8th Cir.1979). Here, plaintiff purchased debentures which,by their terms, were expressly subordinated to all claims having the same or higher priority as savings account holders.

In Northwest Racket Swim & Health Clubs, Inc. v. Federal Sav. & Loan, Ins. Corp., 721 F.Supp. 211 (D.Minn.1989), Judge MacLaughlin, of this court, considered claims virtually identical to these. His analysis in Northwest Racket is fully applicable here.

The words of the subordinated debt agreement are precisely to the contrary of plaintiff's position. The agreement, by its terms, provides for the purchase of subordinated debt. To overcome this contractual bar, plaintiff attempts to establish mutuality based upon the rule set forth in Oppenheimer v. Harriman

Nat'l Bank & Trust Co., 301 U.S. 206 (1937). Claiming Midwest Federal's fraud and misrepresentation, he asserts himself to be a defrauded purchaser. Citing Oppenheimer, plaintiff concludes a defrauded purchaser is entitled to rank on a parity with general creditors. It is, then, to Oppenheimer, its progenitors, and its progeny which the Court must turn.

It is noted, first, that Oppenheimer did not involve subordinated debt. In Oppenheimer the Supreme Court held that defrauded purchasers of a bank's capital stock could rescind their purchase and rank with the bank's unsecured creditors. 301 U.S. at 214-15. The Court, however, found rescission to be contingent upon payment of a statutorily defined

liability to the bank's creditors.[6] "by payment of the comptroller's assessment they fully discharged their liabilit, as stockholders. And as claimants they stand on the same footing as other creditors." 301 U.S. at 215. See also In re Weis Securities, Inc., 605 F.2d 590, 596 n.12 (2d Cir.1978), cert. denied, 439 U.S. 1128 (1979).

This issue was then considered by the Second Circuit in Weis Securities, which did involve subordinated debt. The Second Circuit refused to allow defrauded lenders to rescind their subordination agreements. That court held that when a lender subordinates a loan to enable a

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[6]Prior to 1959, shareholders of a national bank were statutorily liable for all obligations of the bank to the extent of the par value of their shares. 12 U.S.C. §64 [repealed]; In re Weis Securities, Inc., 605 F.2d at 590, 595 (2d Cir. 1978), cert. denied, 439 U.S. 1128 (1979).

securities broker to comply with regulatory capital requirements, the lender will be estopped from rescinding the subordination agreement. 605 F.2d at 596. Weis Securities is consistent with Oppenheimer and reflects the fact that the subordination agreements allowed the broker-dealer to comply with regulatory capital requirements. Id.

In Weis Securities, the Court found that whether customers and creditors of the broker-dealer relied on the subordination agreements was irrelevant. Id. This finding was premised on Scott v. Deveese, 181 U.S. 202 (1901). In Scott, the plaintiff sought to rescind his purchase of bank stock, claiming the purchase was fraudulently induced. The Court denied rescission, finding a purchaser of bank shares must be conclusively presumed to have known he

had increased the bank's capital and facilitated the conduct of its business. Id. at 212.

It is true that in Federal Deposit Ins. Corp. v. United States Nat'l Bank 685 F.2d 270 (9th Cir.1982), the Ninth Circuit allowed a defrauded purchaser to rescind its subordinated note agreement and thereby rank with the bank's other creditors. But, in that case, the court found the loan could not be used for regulatory capital under the National Banking Act. Id. at 274-75. Thus, since the subordinated loan in United States Nat'l Bank was not used to enable the bank to comply with regulatory capital requirements, the Ninth Circuit found Weis Securities was not analogous and the Oppenheimer rule was applicable. Id.

Plaintiff argues that, in the absence of his actual knowledge that his loan to

Midwest Federal would be used to meet Midwest Federal's regulatory capital requirements, he fits within the Oppenheimer rule and Weis Securities does not apply. But, like the plaintiff in Weis Securities, the present plaintiff purchased subordinated debt which allowed Midwest Federal to meet regulatory capital requirements. Opsal Affidavit, ¶¶7-9; Blixt Affidavit ¶¶4-6. Plaintiff's contention, that subjective knowledge is the critical concern, misreads the law.

Close analysis reveals that vindication of regulatory interests in the predicate to rescission. In Oppenheimer, the plaintiff's right to parity with other unsecured creditors accrued only upon his payment of a statutory liability to those creditors. The bank's fraud did not discharge that

liability. 301 U.S. at 214-15. In Weis Securities, the court's holding was based on the purposes underlying regulatory capital requirements. Weis Securities, 605 F.2d at 596. In United States Nat'l Bank, the plaintiff's right to parity with unsecured creditors existed only because the subordinated loans did not, in fact, enable the bank to meet regulatory requirements. 685 F.2d at 274-75. In other words, the regulatory interests in Oppenheimer and Weis Securities were satisfied and there was no regulatory interest implicated in United States Nat'l Bank.

The regulatory capital requirements clearly are designed to bolster public confidence in the stability and integrity of financial institutions, thereby encouraging orderly financial transactions and supporting the national

economy. See Weis Securities, 605 F.2d at 596. "To assure creditors that they could rely on the stated capital resources of a bank, the legislature compelled those who had contributed capital to stand by their commitments." Id. When a subordinated loan is used to enable a financial institution to comply with capital regulations, the subordinated lender properly is estopped from rescinding its agreement. See Weis Securities, 605 F.2d at 596.

In this case, plaintiff expressly purchased subordinated debentures. Amended Complaint Ex. C, title page, introductory paragraph, ¶¶1, 3, 11, 20. Midwest Federal reported these subordinated debentures as part of its regulatory capital. Opsal Affidavit, ¶¶7-9; Blixt Affidavit, ¶¶4-6. Plaintiff's own documents repeatedly

refer to regulatory capital, federal regulations governing subordinated debt and regulatory capital, and Midwest Federal's treatment of other subordinated debt as part of regulatory capital.

The Court finds that, as in Scott v. Deweese, plaintiff must be presumed to know that his loan increased Midwest Federal's capital and facilitated the conduct of its business.[7] See Scott, 181 U.S. 202, 212 (1901). Accordingly, plaintiff's present claim of lack of subjective knowledge that Midwest Federal would report the subordinated debentures as regulatory capital is irrelevant.

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[7]Indeed, at oral argument plaintiff's counsel acknowledged that plaintiff knew he had purchased equity of the bank. Tr. of motion proceedings, at 18 (Aug. 24, 1989).

Plaintiff is a sophisticated businessman.[8] In this transaction, he purchased subordinated debt -- and that is precisely what he received. That debt was made part of Midwest Federal's regulatory capital. As a result, plaintiff is estopped from rescinding the purchase of the debentures and escaping his subordinated status.

As a second line of attack, plaintiff seeks rescission of the transaction under the Minnesota Blue Sky law, Minnesota Statutes, §§ 80A.01 and 80A.23. Equitable principles apply in a purchaser's action. for rescission under § 80A.23. Minnesota Statutes, § 80A.23(1); Logan v. Panuska, 293 N.W.2d 359, 363 (Minn.1980); McCauley v.

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[8]In Weis Securities, the Second Circuit rejected an argument that a lack of sophistication converts a subordinated debenture holder into a general creditor. Weis Securities, 605 F.2d at 597.

Michael. 256 N.W.2d 491, 500 (Minn.1977).

Rescission under § 80A.23 serves a dual function: it protects innocent purchasers and compels sellers to comply with securities regulations by depriving them of ill-gotten gains.[9] Note, The Minnesota Supreme Court: 1980, 65 Minn. L. Rev. 1063, 1069 (1981). Here, neither policy of § 80A.23 will be furthered by allowing rescission.

This transaction, even at this early stage of the proceeding, cannot be regarded as one conducted in the regular course of business dealings. As acknowledged at oral argument, plaintiff took a loan from Midwest Federal and immediately loaned the selfsame funds back to the institution from which he had

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[9]But plaintiffs cannot use the Blue Sky law to save themselves from errors in business judgment; equity will not allow blind protection of purchasers. Logan, 293 N.W.2d at 363.

just secured the loan. Tr. of motion proceedings, at 19-20 (Aug. 24, 1989). These are the funds which purchased the subordinated debt. Id. See Bond v. Charlson, 374 N.W.2d 423, 430 (Minn.1985) (a defrauded purchaser is estopped from rescinding if performed with knowledge of the facts which constituted the fraud).

Plaintiff also asserts a claim for money damages on the basis of common law fraud. In response, the FSLIC seeks to have this claim dismissed as moot since plaintiff can never obtain satisfaction of a money judgment. The Court recognizes that the general rule is "[c]laims for damages or other monetary relief automatically avoid mootness, so long as the claim remains viable." 14A C. Wright & A. Miller, Federal Practice and Procedure, § 3533.3 (1984).

As demonstrated above, plaintiff is a subordinated creditor. The FHLBB has already determined the subordinated debentures are worthless because Midwest Federal's assets were insufficient to satisfy general creditor liabilities. FHLBB Resolution 89-1388 at 3. Thus, the FSLIC argues, even if plaintiff were to succeed on his subordinate debt claims, his victory would be unavailing; his claim is not viable.

At least three courts have ruled that if the receiver would never have any assets with which to satisfy a judgment, a damages action is properly dismissed on prudential grounds. Triland Holdings & Co. v. Sunbelt Serv. Corp., 884 F.2d 205, 208 (5th Cir.1989); Federal Sav. and Loan Ins. Corp. v. Locke, 718 F.Supp. 573, 587 (W.D.Tex.1989); Stevenson v. Federal Sav. and Loan Ins. Corp., 716 F.Supp. 981, 982

(S.D.Tex.1989). This Court adopts this rule.

Accordingly, in order to conserve the limited resources of the judiciary, this Court declines to adjudicate plaintiff's futile damages claim.

Plaintiff, citing Rule 56(f), Fed.R.Civ.P., also asserts defendant's summary judgment motion to be premature, claiming a need to conduct further discovery. The request for additional discovery is wholly general and offers no specifics as to what discovery is sought.[10] A court may grant a continuance

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[10]Under the rule, one who claims a need for additional discovery must file an affidavit stating the reasons they cannot sufficiently establish the existence of a material factual dispute. Beckers v. International Snowmobile Indus. Ass'n, 581 F.2d 1308, 1311 (8th Cir.1978), (citing C. Wright & A. Miller, Federal Practice and Procedure §2740), cert. denied, 440 U.S. 986 (1979). See also Burlington Coat Factory v. Esprit De Corp., 769 F.2d 919, 926 (2d Cir.1985) (affidavit under Rule 56(f) must explain what facts are sought, how they are to be

in accordance with Rule 56(f), Fed.R.Civ.P. United States v. Light, 766 F.2d 394, 398 (8th Cir.1985). That rule, however, does not require a court to order further discovery prior to summary judgment. Id. at 397.

The Court finds no reason for further discovery or for delay here. At oral argument, plaintiff's counsel indicated the proposed discovery pertained to plaintiff's subjective knowledge concerning whether his investment would be used to enable Midwest Federal to comply with regulatory capital

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obtained, how those facts are expected to create an issue of material fact, what efforts the affiant has made to obtain the facts, an why the efforts have been unsuccessful; failure to file such an affidavit is enough to reject a claim of inadequate discovery), aff'd in part, rev'd inpart, 769 F2d 919 (2d Cir.1985).

requirements.[11] Tr. of motion proceedings, at 28-29 (Aug. 24, 1989). The Weis Securities discussion of subjective knowledge, above, makes clear that the proposed discovery would be superfluous.

Plaintiff's final contention is that the purchase and assumption transaction was flawed. This entire argument is premised upon a finding that plaintiff is able to rescind the subordination agreement and occupy the same posture as Midwest Federal's general creditors. The Court has found that plaintiff is not entitled to rescind his agreement and remains a subordinated creditor of Midwest Federal. Thus, since plaintiff is not to be treated as a general creditor, he is not entitled to

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[11]The Court finds it difficult to understand why one would need to conduct discovery to discern his own subjective state of mind.

participate ratably in the distribution of Midwest Federal's assets pursuant to 12 U.S.C. § 1729.

Accordingly, IT IS ORDERED that:

1. The motion of defendant FSLIC as receiver for Midwest Federal to dismiss Counts III, IV, V, VI, and VII of the third amended complaint is granted.

2. In light of this Court's dismissal of all claims against the FSLIC (now RTC), the remaining parties are directed to submit letters to this Court within ten days of this order addressing whether to remand this action to the state court from whence it came.

APPENDIX E

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION
Civil No. 4-89-558

Stephen Adams	)	
	)	
v.	)	ORDER
	)	
Federal Deposit Ins. Corp.	)	

This matter is before the Court on defendant's motion to dismiss or, alternatively, for summary judgment. Defendant's motion is granted. Oral arguments were heard January 12, 1990.

This action arises out of plaintiff's purchase of $2.5 million in subordinated debentures from Midwest Federal. The relevant facts concerning this event are set forth in this Court's February 9, 1990, order in the related case of Adams v. Resolution Trust Corp., et al., Civil No. 4-89-330 (D.Minn). In that order, this Court dismissed plaintiff's claims

against the Resolution Trust Corp. In particular, the Court found plaintiff is not entitled to rescission of the subordinated debenture purchase and therefore retains his subordinated status.

The gravamen of plaintiff's complaint in this case is that the purchase and assumption transaction was flawed and he, as a general creditor, is entitled to ratable distribution. As was acknowledged at oral argument, plaintiff's entire case is premised on a finding that he is entitled to ratable distribution. Tr. of motion proceedings at 20 (Jan. 12, 1990). Because this Court, in Adams v. Resolution Trust Corp., determined plaintiff is not a general creditor entitled to ratable distribution, this action must be dismissed. Accordingly, based on the

files, records, and proceedings herein, IT IS ORDERED that:

Defendant's motion to dismiss is granted and this matter is dismissed with prejudice.

Dated: February 23rd, 1990

/s/ James M. Rosenbaum
JAMES M. ROSENBAUM
United States District Judge

APPENDIX F

STATUES RELIED UPON

		Page
I.	12 U.S.C. § 63	102a
II.	12 U.S.C. § 1441a	103a
III.	12 U.S.C. § 1729	105a

REGULATIONS RELIED UPON

I.	12 C.F.R. § 563.8-1 (1988)	107a
II.	12 C.F.R. § 563.13 (1989)	107a
III.	12 C.F.R. § 567.2(a) (1991)	108a

APPENDIX F

I. 12 U.S.C. § 63

The shareholders of every national banking association shall be held individually responsible, equally and ratably, and not one for another, for all contracts, debts, and engagements of such association, to the extent of the amount of their stock therein, at the par value thereof, in addition to the amount invested in such shares.

Repealed Pub.L. 86-230, § 7, Sept. 8, 1959, 73 Stat. 457.

II. 12 U.S.C. 1441a

Financial Institutions Reform, Recovery and Enforcement Act of 1989

* * *

(b) Resolution Trust Corporation established. (1) Establishment. (A) In general. There is hereby established a Corporation to be known as the Resolution Trust Corporation which shall be an instrumentality of the United States.

* * *

(3) Duties. The duties of the Corporation shall be to carry out a program, under the general oversight of the Oversight Board and through the federal Deposit Insurance Corporation (or any replacement authorized pursuant to subsection (m)), including:

(A) To Manage and resolve all cases involving depository institutions-

(i) the accounts of which were insured by the Federal Savings and Loan Insurance Corporation before the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 [enacted Aug. 9, 1989]; and

(ii) for which a conservator or receiver--

(I) had been appointed at any time during the period beginning on January 1, 1989, and ending on the date of the enactment of such Act (including any institution described in paragraph (6)); or

(II) is appointed within the 3-year period beginning on the date of the enactment of such Act.

(B) To manage the Federal Asset Disposition Association, subject to the provisions of subsection (f)-

(C) To conduct the operations of the Corporation in a manner which--

(i) maximizes the net present value return from the sale or other disposition of institutions described in subparagraph (A) or the assets of such institutions;

(ii) minimizes the impact of such transactions on local real estate and financial markets;

(iii) makes efficient use of funds obtained from the Funding Corporation or from the Treasury;

(iv) minimizes the amount of any loss realized in the resolution of cases; and

(v) maximizes the preservation of the availability and affordability of residential real property for low- and moderate-income individuals.

* * *

(6) Successor to FSLIC as conservator or receiver. As of the date of enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 [enacted Aug. 9, 1989], the Corporation shall succeed the Federal Savings and Loan Insurance Corporation as conservator or receiver with respect to any institution for which the Federal Savings and Loan Insurance Corporation was appointed conservator or receiver during the period beginning on January 1, 1989 and ending on such date of enactment.

III. Federal Savings and Loan Insurance Corporation Act, 12 U.S.C. § 1729, et seq. (excerpt)

A. 12 U.S.C. § 1729[1]

* * *

(b) Powers of corporation on default of Federal Savings and Loan Association. In the event that a Federal savings and loan association is in default, the Corporation shall be appointed as conservator or receiver and is authorized as such (1) to take over the assets of and operate such association, (2) to take such action as may be necessary to put it in a sound and solvent condition, (3) to merge it with another insured institution, (4) to organize a new Federal savings and loan association to take over its assets, or (5) to proceed to liquidate its assets in an orderly manner, whichever shall appear to be to the best interests of the insured members of the association in default; and in any event the Corporation shall pay the insurance as provided in section 405 [§ 1728 of this title] and all valid credit obligations of such association. The surrender and transfer to the Corporation of an insured account in any such association which is in default shall subrogate the Corporation with respect to such insured account, but shall not affect any right which the insured member may have in the uninsured portion of his account or any right which he may have to

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[1]Repealed by Act August 9, 1989, P.L. 101-73, Title IV, § 407, 103 Stat. 363.

participate in the distribution of the net proceeds remaining from the disposition of the assets of such association.

REGULATIONS RELIED UPON

I. 12 C.F.R. § 563.8-1 (1989)

Issuance of subordinated debt securities

(a) General. No insured institution shall issue subordinated debt securities pursuant to this section or amend the terms of such securities unless it has obtained written approval of the Corporation. Approval of the issue under this section, in order to meet the requirements of § 561.13, may be obtained either before or after the securities and the form and manner of filing of the application are in accordance with the provisions of this section.

II. 12 C.F.R. § 563.13 (1989).

Regulatory Capital Requirement.

* * *

(b) Minimum required amount. Except as otherwise provided in this section, the minimum regulatory capital requirement for any calendar quarter (commencing with the quarter ending March 31, 1987) shall be an amount equal to the sum of an institution's liability component and contingency component minus its maturity matching credit. An institution shall not use the maturity matching credit to reduce its required amount of regulatory capital below 3 percent of total liabilities for the period from December 31, 1986, until December 31, 1989, or to reduce its required capital below 4

percent of total liabilities on or after January 1, 1990.

III. 12 C.F.R. § 567.2 (1991)

Minimum regulatory capital requirement

(a) To meet its regulatory capital requirement a savings association must satisfy each of the following capital standards;

(1) Risk-based capital requirement. (i) A savings association's minimum risk-based capital requirement shall be an amount equal to 6% of its risk-weighted assets as measured pursuant to § 567.6 of this part plus 2% of its risk-weighted assets as measured pursuant to that section.

(ii) A savings association may not use supplementary capital to satisfy this requirement in an amount greater than 100% of its core capital as defined in § 567.5 of this part.

APPENDIX G

TRANSCRIPT OF MOTION PROCEEDINGS HAD BEFORE THE HONORABLE JAMES M. ROSENBAUM

August 24, 1989
United States District Court
District of Minnesota

Page 19, Lines 18-25
Page 20, Lines 1-8

THE COURT: Well, let me go a little further here. Are you familiar with the source of the two and a half million dollars:

MR. KELLY: Yes.

THE COURT: Where is that from?

MR. KELLY: It was a bridge loan from Midwest Federal.

THE COURT: So let me get clear in my mind. Midwest Federal loaned two and a half million dollars, and that two and a half million dollars was immediately lent back for subordinated debentures.

MR. KELLY: Yes, Your Honor.

THE COURT: And less than a quarter later, there was a seven and some large change million dollar loan that was made to Mr. Adams, correct?

MR. KELLY: Correct.

(3)

No. 90-1851

Supreme Court, U.S.
FILED
AUG 14 1991
OFFICE OF THE CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1991

STEPHEN ADAMS, PETITIONER

v.

RESOLUTION TRUST CORPORATION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether petitioner is entitled to rescind his purchase of subordinated securities from a now insolvent thrift institution where the purchase agreement and the applicable regulations indicated that the securities would be used to meet the institution's regulatory capital requirements.

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BRIEF FOR THE RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-28a) is reported at 927 F.2d 348. The February 9, 1990, order of the district court (Pet. App. 70a-97a) is reported at 731 F. Supp. 352. The February 23, 1990, order of the district court (Pet. App. 98a-100a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on February 28, 1991. The petition for writ of certiorari was filed on May 29, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Federal Home Loan Bank Board formerly served as the principal regulator of federally chartered thrift institutions.[1] Among other matters, the Bank Board specified terms and conditions under which thrift institutions could issue subordinated debt securities. See 12 C.F.R. 563.8-1 (1988). On December 21, 1987, the Bank Board approved a request from Midwest Federal Savings and Loan Association (MWF), a federally insured savings institution, to issue up to $25 million in MWF subordinated debt securities. Petitioner, Stephen Adams, purchased $2.5 million of those securities from MWF through a private offering. Petitioner financed his investment with the proceeds from a promissory note with MWF that he executed on the same day. Shortly after the consummation of the sale, MWF applied the securities to its regulatory capital. Pet. App. 4a-5a, 8a-9a, 72a.[2]

Petitioner and MWF entered into a "Subordinated Debt Securities Agreement" at the time of the purchase. The Agreement gave petitioner certain limited

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[1] The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, abolished the Bank Board and replaced it with the Office of Thrift Supervision, §§ 301, 401, 103 Stat. 278, 354; see 12 U.S.C. 1462a (Supp. I 1989).

[2] Federally chartered financial institutions must meet federally prescribed capital requirements. Under the Bank Board's regulations, regulatory capital included reserve accounts, retained earnings, permanent common stock, securities constituting equity capital, appraised equity capital, and any other nonwithdrawable reserve accounts that could be used to satisfy the claims of depositors and other account holders. Pet. App. 9a n.6. The Bank Board also included subordinated debt securities as regulatory capital pursuant to 12 C.F.R. 561.13(c)(1) (1988). See Pet. App. 9a n.6.

remedies in the event of MWF's default.[3] First, it provided that petitioner could accelerate payment in the event of default only to the extent that such payment did not leave MWF with insufficient capital to meet regulatory capital requirements set out in 12 C.F.R. 563.13 (1988). Second, it stated that if the Federal Savings and Loan Insurance Corporation (FSLIC) were appointed as a receiver for MWF, FSLIC would not have any obligation to arrange for the assumption of the securities.[4] Third, it provided that petitioner agreed to abide by the Bank Board's priority regulations governing the distribution of assets in receivership proceedings. Both the security instruments themselves and the Agreement expressly provided that, in the event MWF were liquidated, petitioner's interests would be subordinated to claims of savings account holders and to all other claims having a priority equal to or greater than that of savings account holders. Pet. App. 5a-8a, 75a-77a.

2. In January 1989, the Bank Board concluded that MWF had improperly treated the securities issued to petitioner as regulatory capital, because petitioner had purchased them with unsecured funds borrowed from MWF. The Bank Board ordered MWF prospec-

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[3] The Agreement defined default by MWF to include the failure to make timely payments of interest or principal, the declaration of insolvency and appointment of a conservator, receiver or liquidating agent, and any false representations or warranties made by MWF in connection with the contemplated transactions. Pet. App. 5a-6a.

[4] Congress has since abolished FSLIC. See FIRREA, § 401(a), 103 Stat. 354. The Resolution Trust Corporation (RTC) assumed the FSLIC liquidation function for all savings and loan institutions placed in conservatorship or receivership after January 1, 1989. FIRREA, § 501(b)(3)(A), 103 Stat. 369, 12 U.S.C. 1441a(b)(3)(A) (Supp. I 1989).

tively to cease treating the securities as such. On February 13, 1989, the Bank Board declared MWF insolvent and appointed the FSLIC as conservator for the institution. On March 21, 1989, petitioner filed a complaint in state court against MWF and its officers alleging that MWF's misrepresentations at the time of the sale violated both federal and state securities laws. Petitioner asked the court to rescind the securities sale and to allow a set-off of the amount that MWF owed him for the securities against his obligation to MWF under the outstanding promissory note. He also asserted state law remedies for fraud. Pet. App. 10a-12a, 73a.

On May 4, 1989, the Bank Board determined that MWF remained insolvent, and it appointed FSLIC as receiver pursuant to 12 U.S.C. 1464(d)(6)(A) and 12 C.F.R. Pt. 547 (1988) for the purpose of liquidating the institution. The Bank Board also found that the total liquidation of MWF could not generate sufficient funds to satisfy the claims of MWF's general creditors, and it therefore determined that all equity and subordinated debt interests in MWF were worthless.[5] To effectuate the liquidation, the Bank Board created a new institution, Midwest Savings Association (Midwest), and immediately placed it into conservatorship. The Bank Board then directed FSLIC to enter into a purchase and assumption agreement with Midwest by which the majority of MWF's assets were transferred to Midwest in consideration for Midwest assuming certain liabilities of the failed institution. Under the agreement, Midwest did not

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[5] Under the FSLIC priority scheme, subordinated debt holders were paid only after all other creditors, except equity interest holders, were paid. 12 C.F.R. 569c.11 (1989). See Pet. App. 8a n.5.

assume any MWF subordinated debt or equity liabilities or obligations. As a result, Midwest received petitioner's promissory note while FSLIC, as receiver for MWF, retained MWF's obligations on the securities. Pet. App. 12a-14a, 73a-74a.

3. Petitioner's pending civil action was removed to the United States District Court for the District of Minnesota. Pet. App. 73a n.3. The Resolution Trust Corporation (RTC) thereafter assumed FSLIC's conservatorship and receivership responsibilities. RTC, acting as conservator for Midwest and receiver for MWF, sought to dismiss petitioner's claims seeking rescission of the securities transaction and a set-off against the promissory note. On February 9, 1989, the district court granted summary judgment for RTC. *Id.* at 70a-97a. The district court concluded that petitioner was estopped from rescinding his purchase because petitioner presumptively knew that the securities were used to increase MWF's regulatory capital, and the court concluded that petitioner was not entitled to a set-off because the securities and the promissory note were not mutual obligations. *Id.* at 80a-90a. The district court also dismissed petitioner's state-law based statutory and common law claims. *Id.* at 90a-94a.[6]

4. The court of appeals affirmed the district court's decisions, Pet. App. 1a-28a, relying on its decision,

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[6] Petitioner also filed a separate, but related, action against FSLIC in its corporate capacity alleging that FSLIC's purchase and assumption agreement was unlawful and that he was entitled to pro rata distribution. Pursuant to FIRREA, the Federal Deposit Insurance Corporation (FDIC) was substituted for FSLIC with respect to that claim. See FIRREA, § 401, 103 Stat. 354. On February 23, 1990, the district court dismissed that action based on its reasoning in the prior action. Pet. App. 98a-100a.

filed the same day, in *Northwest Racquet Swim & Health Clubs, Inc.* v. *RTC*, 927 F.2d 355, petition for cert. pending, No. 90-1825 (filed May 28, 1991). The court explained that "where investors in a federally regulated institution subordinate their claims in such a manner as to make the investments eligible for use as regulatory capital, and where the issuing institution applies such investments to regulatory capital, the investments must be regarded as fully encumbered by the regulatory obligation to remain subordinate to the claims of depositors and general creditors in the event of insolvency." Pet. App. 20a. Thus, once MWF was declared insolvent, petitioner could not rescind his obligation and share in any pro rata distribution with MWF's general creditors. *Id.* at 22a. The court also affirmed the district court's dismissal of petitioner's other claims. *Id.* at 22a-27a.

ARGUMENT

The court of appeals correctly affirmed the district court's determination that petitioner was not entitled to a rescission or set-off of the subordinated debt obligation. The court's decision rests on the application of established law to the facts of this case and does not conflict with any decision of this Court or another court of appeals. Further review is accordingly unwarranted.[7]

1. The court of appeals correctly applied its decision in *Northwest Racquet* to the essentially identical facts of this case. See Pet. App. 19a-23a. That decision holds that where a federally regulated financial institution has issued a subordinated debt security to meet regulatory capital requirements, an investor

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[7] The same issue is presented in the petition for a writ of certiorari in *Northwest Racquet Swim & Health Clubs, Inc.* v. *RTC*, No. 90-1825.

cannot rescind his purchase of the security once the institution becomes insolvent and the reserved capital must be called upon to satisfy the demands of unsubordinated creditors. See 927 F.2d at 362. In reaching that conclusion, the court of appeals properly followed the Second Circuit's decision in *In re Weis Securities, Inc.*, 605 F.2d 590 (1978), cert. denied, 439 U.S. 1128 (1979).[8]

2. Petitioner mistakenly contends (Pet 26-30) that the court of appeals' decision is inconsistent with this Court's decision in *Oppenheimer* v. *Harriman Nat'l Bank & Trust Co.*, 301 U.S. 206 (1937). In *Oppenheimer*, this Court permitted a shareholder of a national bank to maintain his action for rescission, but *only* after he had paid his statutory liability to other creditors pur-

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[8] In *Weis*, a securities broker borrowed money to meet the securities industry's regulatory capital requirements. The lenders subordinated their loans to the claims of other creditors in exchange for a higher rate of return. When the broker became insolvent, the lenders sought to rescind the loan agreements based—as here—on claims of fraudulent inducement. The Second Circuit held that the lenders were not entitled to post-insolvency rescission, because the loans were applied to meet regulatory capital requirements and the lenders were estopped, by their acceptance of their subordinated status, to make post-insolvency challenges to that status. 605 F.2d at 596-597.

The same principle applies in this case. As the court of appeals explained, the regulatory capital requirements of the thrift industry, like those in the securities industry, are designed to protect the interests of the unsubordinated creditors. *Northwest Racquet*, 927 F.2d at 360-361. That protection would be similarly undermined if an investor who purchases a thrift institution's subordinated debentures may rescind his agreement and compromise the associated capital reserves once insolvency occurs. Cf. *Scott* v. *Deweese*, 181 U.S. 202 (1901) (holding that an equity shareholder of a national bank who alleged fraud in the inducement may not obtain a post-insolvency rescission of his subscription).

suant to 12 U.S.C. 63 (1958) (repealed 1959). *Oppenheimer*, 301 U.S. at 211. The Court explained that the "[p]laintiff appeared by the bank's records to be a stockholder and, as against creditors for whose benefit the statutory liability was created, was estopped from denying that status." *Id.* at 214 & n. 14 (citing *Scott* v. *Deweese*, 181 U.S. 202 (1901)). The Court concluded, however, that "having fully paid his liability to the creditors, there is no reason why his claim should be subordinated to claims of stockholders on account of their deposit balances when the bank failed." *Id.* at 215. Thus, the court of appeals' decision follows *Oppenheimer*'s underlying rationale that where an investor in an insolvent institution owes a legal obligation to the institution's general creditors, the investor must satisfy that obligation before it can rescind its investment.[9]

Petitioner also argues (Pet. 33-37) that the court of appeals' decision "distorts" the Second Circuit's decision in *Weis* because "the *Weis* investors *knew* that the broker-dealer was in precarious financial circumstances and their loans were being used to satisfy the regulators" (*id.* at 34). The court of appeals correctly rejected that argument in its *Northwest Racquet* decision. The court acknowledged that "the specific intention of the lenders in *Weis* was a factor in the Second Circuit's decision," but further explained that the

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[9] Petitioner suggests that *Oppenheimer* stands for the proposition that "unless Congress 'unquestionably' demonstrates an intention not to allow investors to rescind fraudulently induced investments, they have that right." Pet. 30. Both the Eighth and the Second Circuits, however, have rejected that argument. See *Northwest Racquet*, 927 F.2d at 362 n.17; *Weis*, 605 F.2d at 596 n.12. No other court of appeals has considered the matter. Thus, even if there were merit to petitioner's argument, the question is not ripe for this Court's resolution.

Second Circuit's rationale "extends to situations in which parties subordinate their claims in such a manner as to make the investments eligible for use as regulatory capital." 927 F.2d at 362. "Any other result would undermine the regulatory protections and priorities accorded innocent third parties who rely upon stated capital reserves." *Ibid.*[10]

Petitioner is also mistaken in contending (Pet. 37 n.7) that the court of appeals' decision conflicts with the Ninth Circuit's decision in *FDIC* v. *United States Nat'l Bank*, 685 F.2d 270 (1982). In that case, the court permitted a defrauded subordinated debenture holder to rescind its purchase, because there was no evidence that the debentures were used as regulatory capital. 685 F.2d at 274. Indeed, the statute and regulations that applied in that case did not permit subordinated loans to be used as regulatory capital. *Id.* at 274-275. Hence, the Ninth Circuit's decision does not conflict with the court's decision in this case. See *Northwest Racquet*, 927 F.2d at 363 n.20

3. Petitioner also argues (Pet. 40) that the court of appeals' decision deprives investors of "any realistic remedy." As the court expressly stated in *Northwest Racquet*, however, its decision does not affect an investor's remedies prior to a declaration of insolvency. 927 F.2d at 363. And contrary to petitioner's assertions (Pet. 40-43), there is no reason to believe that the court's decision will "impair the ability of surviving thrifts to raise capital." Indeed, petitioner's ap-

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[10] Here, petitioner was clearly on notice that his investment would be applied to regulatory capital requirements. See Pet. App. 20a-21a, 88a-89a. Compare *Weis*, 605 F.2d at 595 ("one who purchased bank shares must be conclusively presumed to have known that he had increased the bank's capital and had facilitated its conduct of business" (citing *Scott* v. *Deweese*, 181 U.S. at 212)).

proach would result in thrifts raising reserved capital that simply vanishes, through rescission, upon a declaration of insolvency. The court's decision, by contrast, will provide greater prospects that a thrift's stated capital reserves will actually be available to meet the thrift's obligations to its creditors, and it will encourage investors to make prudent inquiry before investing in subordinated debt.[11]

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[11] There is no merit to petitioner's argument (Pet. 31-33) that the court of appeals' "real rationale" in this case was to protect the government at the expense of a private party. The court's "real rationale" is the rationale set forth in the panel's unanimous opinion. Similarly, there is no merit to petitioner's rhetoric (Pet. 38-40) that the court of appeals has allowed the federal government to "complete" MWF's alleged fraud. The court of appeals' decision simply gives effect to the expectations of *all* general creditors, both public and private, that their claims will remain superior to subordinated claims.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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